IN THE

Supreme Court of the United States

October Term, 1946
No. 365

EDWARD R. DOWNING, suing on his own behalf, and on behalf of all other stockholders of THE UNITED CORPORATION (of Delaware), etc.,

Petitioner,

against

GEORGE H. HOWARD, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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To the Honorable Chief Justice of the United States and the Honorable Associate Justices of the Supreme Court of the United States:

Your Petitioner respectfully shows:

Summary Statement of Matter Involved

Petitioner is a stockholder of The United Corporation (of Delaware), hereafter referred to as United. He brought this action in August 1944 in the United States District Court for the District of Delaware (R. 1a) on behalf of himself, other stockholders of United, and the corporation, against individuals (or in some instances, the personal representatives of their estates) who were or had been

officers or directors of United or had been members of banking firms or companies alleged to have controlled the directors and conspired with them for their own profit and to the damage of the corporation and its stockholders. The unlawful acts complained of consisted of willfully causing the corporation to do certain acts in violation of the provisions of Sections 4(a) and (b) and 11(e) of the Public Utility Holding Company Act of 1935 (hereafter referred to as the Act).

All but three of the individual defendants are non-residents of Delaware and were served with process outside of that state (R. 4a, 6a, 7a, 8a). Petitioner concedes that such service was not effective unless this is an action based on the Public Utility Holding Company Act of 1935, Section 25 of which expressly provides for such extra-territorial service. Petitioner also concedes that he is not properly in a federal court if his action does not arise under that Act, since there is no diversity of citizenship between Petitioner and three of the defendants.

The defendants moved to dismiss the action on some or all the defenses numbered (1) to (5) of Rule 12(b) of the Federal Rules of Civil Procedure (R. 73a, 75a, 77a, 79a, 80a, 82a, 84a, 86a, 87a, 89a, 91a, 93a, 95a, 97a, 99a, 101a). The District Court granted the motions to dismiss on the ground that it lacked jurisdiction over the subject matter of the action (R. 126a-139a, 144a-146a) and the Circuit Court of Appeals for the Third Circuit affirmed the dismissal on that ground (R. fol. 152a). Neither court therefore found it necessary to pass upon the questions raised by defendants' motions as to the propriety of the venue of the action or the effectiveness of the service of process on

those non-resident defendants who were the representatives of the estates of deceased directors, assuming that the action was properly based on the Public Utility Holding Company Act of 1935.

The Amended Complaint

The defendants' motions were directed to the Amended Complaint, filed in August 1945, which sets forth the following facts in three separate causes of action (R. 11a-70a).

First Cause of Action

The United Corporation was incorporated under the laws of Delaware in 1929. Its principal organizers were J. P. Morgan & Company, whose partners are named as defendants in this action, the defendant Landon K. Thorne, Bonbright & Company, Inc. (now known as Commercial Enterprises Corporation, a defendant herein), Bonbright Electrical Corporation (now known as Bonbright, Loomis & Company, Inc., a defendant herein) and the defendant Alfred L. Loomis, all of whom were at that time engaged directly or indirectly in the business of commercial and investment banking (R. 13a, 14a, 21a). From the time of the organization of United in 1929 until August 1945, when the Amended Complaint was filed, through control of the proxy committee and ownership of substantial amounts of outstanding voting stock of United, and also by agreement with various persons directly and indirectly owning large amounts of outstanding voting stock of United, the defendants above referred to elected the Board of Directors of United, and dominated and controlled the manage-

ment and policies of United and of the various subsidiary holding companies and operating companies in the United holding-company system (R. 20a-22a).

On August 26, 1935, the Public Utility Holding Company Act of 1935 became law. United, its four principal subsidiaries and many of its sub-sidiaries, were holding companies as defined in that Act. Section 4(a) made it unlawful after December 1, 1935, for any holding company, unless it registered under Section 5, to perform any of the acts enumerated in Section 4(a). United, in fact, did not register under Section 5 at any time from the passage of the Act until March 28, 1938. On that date it registered (R. 23a-29a).

Section 4(a) expressly made it unlawful for an unregistered holding company "to own, control or hold with power to vote, any security of any subsidiary company. * * *" The defendants nevertheless caused United, while unregistered, to continue to own, control and hold with power to vote the securities of its subsidiary companies (R. 29a, 30a). The reason that the defendants caused United to continue to hold these securities was to enable the controlling banking interests referred to above to continue to realize profits after December 31, 1935, as they had prior to that date, through the instrumentality of United. For prior to that date J. P. Morgan & Company had realized net profits of over $19,000,000, and Landon K. Thorne, Bonbright & Company, Inc. and Alfred K. Loomis directly and indirectly had realized profits of approximately $18,000,000 from fees, interest, loans and transactions in the securities of United. By causing United to continue to own these securities of its subsidiaries, the

defendants continued their domination and control over the United holding-company system and thereby were enabled to continue to make substantial profits during the period December 1, 1935 to March 28, 1938, while United was unregistered. J. P. Morgan & Company profited from the deposit of moneys with it by companies in the United system, including moneys derived by the companies from sale of their securities to underwriters, the total amount of such securities underwritten during this period amounting to approximately $479,000,000. In addition, the partners of J. P. Morgan & Company profited through their stock ownership in Morgan, Stanley & Co., Inc., which received underwriting fees from companies in the United system amounting to more than $2,000,000 (R. 32a-34a).

Apart from the profits realized by the defendants, their action in causing United to continue to own the securities of its subsidiaries resulted in great damage to the stockholders of United. The market value of the securities of the subsidiaries which United owned on December 1, 1935, amounted to approximately $194,000,000. On March 28, 1938, this value had decreased to $107,000,000, a loss of value amount approximately to $87,000,000. The value of the securities in August, 1945, when the Amended Complaint was filed, was still far below that of December 1, 1935 (R. 36a).

During the thirteen months following December 1, 1935, it would have been possible for United to divest itself of these securities and realize a sum approximating their December 1, 1935 market value, or to distribute its securities to its stockholders by way of dissolution or reorganization. In addition, between December 1, 1935 and March

28, 1938, United expended approximately $1,000,000 in salaries, legal and auditing fees, taxes, and other business and administration expenses arising out of its retention of ownership of the securities of its subsidiaries during this period in violation of Section 4(a) of the Public Utility Holding Company Act of 1935 (R. 31a, 36a).

Second Cause of Action

In February 1937, United owned 1,914,417 shares of the outstanding voting common stock of Niagara Hudson Power Corporation, and approximately 62,370 shares of the outstanding voting second preferred stock of Mohawk Hudson Power Corporation. Niagara was a subsidiary of United and Mohawk was a subsidiary of Niagara (and also of United) (R. 40a, 41a).

Under a proposed plan to consolidate Mohawk and Niagara into a new corporation called Consolidated Niagara Hudson Power Corporation, the holders of Mohawk second preferred stock were given a choice of exchanging one share of stock either for seven shares of Consolidated Niagara common stock or for one share of Consolidated Niagara 5% second preferred and 1½ shares of Consolidated Niagara common stock. Acceptance of the seven shares of Consolidated Niagara common required waiving rights to dividends which had accumulated for three years prior to February 1, 1937, on the Mohawk second preferred. The plan further provided that if a holder of Mohawk second preferred did not choose either option, he would automatically receive one share of the Consolidated Niagara 5% cumulative second preferred, carrying a right to a special dividend equivalent to the dividend accumu-

lated on the Mohawk second preferred. The defendants caused United to vote its shares of stock in favor of the consolidation. The plan could not have been approved by the required percentage of stock without the votes of the stock owned by United. The defendants also caused United to elect to exchange its shares of Mohawk second preferred on the basis of one share of that stock for seven shares of Consolidated Niagara common, with the result that United acquired 436,590 shares of Consolidated Niagara common stock. The foregoing acts of exchanging securities, negotiating for the acquisition of and acquiring said shares of Consolidated Niagara common stock were, to the knowledge of the defendants, in violation of Section 4(a)(3) and (4) of the Act (R. 40a, 41a).

If United had not elected to acquire such shares of Consolidated Niagara common, it would have received, by automatic operation of the plan of consolidation, one share of Consolidated Niagara second preferred, carrying the special dividend rights referred to above, for each share of Mohawk second preferred which it had owned. The dividends that United waived by making the election which it did amounted to approximately $935,550. Dividends of that character were in fact paid by Consolidated Niagara subsequent to 1936 to those holders of Mohawk second preferred who did not make either election and who consequently received Consolidated Niagara second preferred together with the special dividend rights (R. 42a-44a).

Furthermore, dividends of $5.00 a year have either been paid or have accumulated on the Consolidated Niagara second preferred from 1937 to the present time. This would have amounted to $311,850 a year on the 62,370 shares of

Consolidated Niagara second preferred, which United would have received or become entitled to if it had refrained from making the affirmative election which it did. The 436,590 shares of Consolidated Niagara common stock acquired and still owned by United now have a market value of approximately $1,309,900 as compared with a present market value of $4,241,000 for the 62,370 shares of Consolidated Niagara second preferred which United would have received under the automatic provisions of the consolidation plan. Furthermore, the value of the common shares of Consolidated Niagara has substantially diminished with the result that the total value of United's 436,590 shares of that stock is far below the February 1937 value of the 62,370 shares of Mohawk stock which United gave in exchange therefor (R. 43a, 44a).

Third Cause of Action

The defendants other than United caused United to fail to register with the Securities and Exchange Commission from December 1, 1935 to March 28, 1938, although it was required to register by Section 4(b) of the Act. On March 28, 1938 it registered (R. 29a).

Section 11(e) authorized any registered holding company at any time after January 1, 1936 to submit a plan to the Securities and Exchange Commission for the divestment of control, securities or other assets, or for other action for the purpose of enabling such company to comply with the provisions of Section 11(b).

Between 1936 and the date of the filing of the Amended Complaint, United contributed nothing to the normal functioning of its system companies, and its continued existence

unduly and unnecessarily complicated the structure of the system. United rendered no public utility or other services to its system companies, its chief business function being merely to hold the securities of its subsidiaries and certain other corporations. For these reasons United was required by Section 11 to cease to be a holding company and it was the duty of its directors to cause United to cease to own 10% of the stock of its subsidiaries. Nevertheless, United took no steps to insure that its corporate structure and existence did not unduly or unnecessarily complicate the structure of its holding company system, and United did not cease to hold and own the voting stock of its subsidiaries, although it could have done so (R. 52a-54a).

On March 4, 1941, United did file an application with the Commission under Section 11(e) for approval of an alleged "plan" for divestment of control and securities of subsidiaries, but the Commission, after hearings held between November 17, 1941 and January 18, 1942, issued an order dated August 14, 1943, disapproving the purported plan and directing United to cease to be a holding company. The defendants, nevertheless, caused United to continue to own more than 10% of the outstanding voting shares of its subsidiaries (R. 52a-55a).

The reason the defendants caused United to continue to own the securities of its subsidiaries and to fail to file a plan, was in order to enable the defendant banking interests to continue to realize profits as they had in the past, through the instrumentality of United. Between January 1, 1936 and the filing of the Amended Complaint in August 1935, the value of the securities owned by United in its subsidiaries decreased approximately $87,000,000. In ad-

dition, United expended considerable sums in payment of salaries, legal and auditing fees, taxes, and other business expenses, all arising out of its continued retention of ownership of the securities of its subsidiaries (R. 56a-60a).

Questions Presented

1. Does the Public Utility Holding Company Act of 1935 give a stockholder of a public utility holding company a right of action against its officers and directors, and affiliated banking interests who controlled them, for damages and profits resulting from their actions in willfully causing such company, while unregistered, to own the securities of subsidiary companies, in violation of the express prohibition contained in Section 4(a)(6)?

2. Does the Public Utility Holding Company Act of 1935 give a stockholder of a public utility holding company a right of action against its officers and directors, and affiliated banking interests who controlled them, for damages and profits resulting from their actions in willfully causing such company, while unregistered, to exchange the securities of subsidiary companies, in violation of the express prohibitions contained in Section 4(a)(3) and (4)?

3. Does the Public Utility Holding Company Act of 1935 give a stockholder of a public utility holding company a right of action against its officers and directors, and affiliated banking interests who controlled them, for damages and profits resulting from their actions in willfully causing such company to fail to register pursuant to the provisions of Section 4(b) until March 28, 1938 and, after

it registered on that date, to fail to file a plan under Section 11(e) for the divestment of control, securities or other assets, or for other action enabling the company to comply with the provisions of Section 11(b), where the company is economically unnecessary and performs no services for its system companies?

The Petitioner contends that all three questions should be answered in the affirmative. The District Court and the Circuit Court of Appeals below answered them all in the negative. Even if Petitioner's position is correct as to only one of these questions, it was error for the courts below to dismiss the action.

Reasons Relied on for the Allowance of the Writ

1. The Circuit Court of Appeals has decided important questions relating to the interpretation of Sections 4(a), 4(b) and 11(e) of the Public Utility Holding Company Act of 1935 which have not been, but should be, settled by this Court.

Although in *Electric Bond & Share Co.* v. *Securities and Exchange Commission*, 303 U. S. 419, 442, this Court upheld the constitutionality of Section 4(a) in an action brought by the Securities and Exchange Commission, it has never had occasion to define the extent to which that section creates civil liability to private parties on the part of persons who willfully cause holding companies to violate its provisions. Nor has it ever determined whether Section 11(e) imposes any duty upon the directors of an economically unnecessary holding company, which fails to comply with the standards of Section 11(b), to cause such company to file a plan enabling it to comply with those

provisions. It is believed that these are matters of great importance both to investors in the securities of public utility holding companies and to the officers and directors of such companies.

2. The Circuit Court of Appeals has decided questions of interpretation of Section 4(a) in a way probably in conflict with applicable decisions of this Court.

By holding that directors who cause an unregistered holding company to do acts expressly proscribed by statute which result in damage to persons indisputably within a class intended to be protected by such statute, are not civilly liable to such persons, the decision of the Circuit Court of Appeals appears to be in conflict with the decision enunciated by this Court in *Texas & Pacific R.R.* v. *Rigsby*, 241 U. S. 33. In that case it was held that the disregard of a statute is an unlawful act and that where it results in damage to a member of a class for whose especial benefit the statute was enacted, the right to recover in a civil action is implied, even though the statute does not expressly provide for a civil right of action.

3. The decision of the Circuit Court of Appeals is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Goldstein* v. *Groesbeck, et al.*, 142 F. 2d 422 (C. C. A. 2, 1944), cert. den. 323 U. S. 737.

In that case the Circuit Court of Appeals for the Second Circuit held that the Public Utility Holding Company Act of 1935 gave a stockholder of an intermediate holding company a right of action against the top holding company and its officers and directors based on service and

construction contracts made by the top holding company, while unregistered, in violation of the prohibition against such contracts contained in Section 4(a)(2). The ground of the Court's decision was that the Act would be not only "sadly wanting" but "delusive" if it did not provide a private right of action "to those for whose ultimate protection" the statute was intended. See *Goldstein* v. *Groesbeck, supra,* at p. 427. Although the opinion below of the Circuit Court of Appeals for the Third Circuit did not express any disagreement with the decision in that case, it is Petitioner's position that the bases of the decisions are in conflict and necessarily lead to conflicting conclusions as to the extent of civil liability to private parties under Section 4(a).

4. The case involves important questions relating to the interpretation of the provisions of Section 25 of the Public Utility Holding Company Act of 1935 dealing with venue and jurisdiction over the person, which have not been, but should be, settled by this Court.

Assuming that, as Petitioner contends, the Amended Complaint sets forth valid claims under the Act, the defendants' motions attack the propriety of the venue of the action and the effectiveness of the service of process beyond the territorial limits of Delaware on non-resident defendants who are the representatives of decedents' estates. The Courts below found it unnecessary to pass upon these questions in view of their conclusions that the action was not based on the Act; but if, as Petitioner contends, these conclusions are incorrect, it will be necessary to determine these questions in order to make a complete disposition of this case.

It is Petitioner's position that the action was properly brought in the District of Delaware (under Section 25 of the Act, which provides for the bringing of an action "in the district wherein any act or transaction constituting the violation occurred") because the acts of United in owning and exchanging securities in violation of Section 4(a) took place in Delaware, the State of United's incorporation and in which it had its principal place of business, and because the acts of United were attributable to the defendants who caused United to commit such acts. The Memorandum filed by the Securities and Exchange Commission as *amicus curiae* in the Circuit Court of Appeals agreed that the venue of the action was proper, and also agreed that the service of process pursuant to Section 25 was effective in giving the District Court jurisdiction over the persons of non-resident defendants who were the executors or trustees of decedents' estates.*

WHEREFORE, Petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Third Circuit commanding that Court to certify to and send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court had in the case numbered and entitled in its docket as "No. 9314, Edward R. Downing, etc., Appel-

* The Commission's Memorandum was submitted "with respect to certain of the issues raised by this appeal which present important questions as to the construction of the Public Utility Holding Company Act of 1935;" but, in conformity with its general policy of avoiding participation in private litigation concerning violations of Section 4, the Commission expressly refrained from taking any position on the question whether the Amended Complaint stated valid claims based on Section 4(a)). *Memorandum of Securities and Exchange Commission, Amicus Curiae*, pp. 1, 2.

lant, v. George H. Howard, et al." and that the judgment of said Court, affirming the judgments of the United States District Court for the District of Delaware, be reversed by this Court.

Dated: September 22, 1947.

EDWARD R. DOWNING,
Petitioner.

By JAMES R. MORFORD,
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JOHN F. DAVIDSON,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTORARI

Opinions of Courts Below

The opinion of the Circuit Court of Appeals (R. fol. 152a) is not yet reported. The opinion of the District Court (R. 126-139a, 144a-146a) is reported in 68 F. Supp. 6.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered June 24, 1947 (R. fol. 152a). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. 347).

Statement of the Case

The statement at pages 1-11 of the preceding petition is hereby adopted and made a part of this brief.

Specifications of Error

1. The Circuit Court of Appeals erred in holding, as to the "First Cause of Action," that:

(a) In order for a complaint by a stockholder of an unregistered public utility holding company to state a valid claim based on violation of Section 4(a)(6) of the Public Utility Holding Company Act of 1935, it must allege that the damages to such company's stockholders resulted from the company's "failure to register" under Section 5, rather than from its ownership of securities of subsidiaries in violation of the express prohibition of Section 4(a)(6).

(b) A complaint in a derivative action brought by a stockholder of an unregistered holding company against its officers and directors can not state a valid claim under Section 4(a)(6) unless it alleges as a fact that the damages complained of would not have occurred if the holding company had been a registered holding company.

(c) Ownership of securities of its subsidiaries by an unregistered holding company in violation of Section 4(a)(6) is not the legal cause of damage to the stockholders of such company where the decline in the value of such securities is not alleged to be the result of the holding company's failure to register.

(d) In effect, the *only* purpose of Section 4(a) was to compel holding companies to register.

(e) A complaint fails to state a valid claim based on Section 4(a)(6) even though it alleges that the directors of a holding company, and affiliated banking interests who controlled them, realized profits as the result of causing the company, while unregistered, to own the securities of subsidiaries, in violation of that section.

(f) Causing an unregistered holding company to own securities in violation of Section 4(a)(6) is not the legal cause of damage to stockholders of such company unless its directors are held liable as insurers against all harm.

(g) A complaint which is defective in any of the foregoing respects should be dismissed for lack of jurisdiction over the subject matter of the action.

2. The Circuit Court of Appeals erred in holding, as to the "Second Cause of Action," that:

(a) The exchange of securities of its subsidiaries by an unregistered holding company in violation of Section 4(a)(3) and (4) is not the legal cause of damage to the stockholders of such company where the complaint does not allege as a fact that the loss resulting from such exchange would not have occurred if such company had been a registered holding company.

(b) In order for a complaint to state a valid claim under Section 4(a)(3) and (4), it must allege that the loss resulting from an exchange effected by an unregistered holding company in violation of the provisions of that section was caused by the holding company's failure to register.

(c) Causing an unregistered holding company to exchange securities of its subsidiaries in violation of Sections 4(a)(3) and (4) is not the legal cause of damage to stockholders of the company, unless its directors are held liable as insurers against all harm.

(d) Even if a complaint alleged that an exchange of securities of subsidiaries prohibited by Section 4(a)(3) and (4) would never have taken place if the holding company had been registered, it would still be legally insufficient unless it stated facts to show that the resulting loss to stockholders of the company happened in a way which the statute was enacted to prevent.

(e) A complaint which fails to contain any of the foregoing allegations should be dismissed for lack of jurisdiction over the subject matter of the action.

3. The Circuit Court of Appeals erred in holding, as to the "Third Cause of Action," that:

(a) Section 11(e) imposes no duty upon officers and directors of an economically unnecessary registered holding company, which renders no services to its system companies and whose structure does not conform to the standards of Section 11(b), to file a plan of divestment or control, or for the purpose of bringing the company into compliance with the provisions of Section 11(b).

4. The Circuit Court of Appeals erred in failing to hold that if the Amended Complaint states one or more valid claims under the Public Utility Holding Company Act of 1935, the District Court has jurisdiction over the persons of non-resident defendants who are the representatives of

decedents' estates as well as over the persons of the other individual defendants.

5. The Circuit Court of Appeals erred in failing to hold that if the Amended Complaint states one or more valid claims under the Public Utility Holding Company Act of 1935, the venue of the action is properly laid in the District of Delaware.

ARGUMENT

Summary of Argument

First and Second Causes of Action

Section 4(a) expressly makes it unlawful for an unregistered holding company to own or to exchange the securities of subsidiary companies. The law is settled that where a statute is enacted for the protection of a certain class of persons, a member of that class who is injured as the result of a violation of the statute may recover damages from the violator even though the statute does not expressly provide for a civil right of action. It is also settled that the directors of a corporation who cause it to violate a statute are individually liable for damages resulting from such violation. Petitioner, a stockholder of a public utility holding company, is a member of a class which the Act was designed to protect. He was injured by the willful acts of the directors of United in causing United, while unregistered, to own and to exchange the securities of subsidiary companies in violation of Section 4(a). Petitioner therefore has a right of action against the directors of United based on violations of Section 4(a) even though that section does not expressly provide for a civil action.

It was error for the Circuit Court of Appeals to limit the creation of a right of action for violation of Section 4(a) to cases in which the damages result from failure to register under Section 5. This conclusion is based upon the incorrect assumption that the *only* purpose of Section 4(a) was to cause holding companies to register. Both the Act itself and its legislative background show that Section 4(a) was intended to proscribe to unregistered holding companies the acts therein enumerated because such acts by unregistered holding companies were regarded as substantive evils in themselves and not merely because it was intended to exert pressure on such companies in order to cause them to register.

The acts done in violation of Section 4(a) were the legal cause of the damage to the Petitioner since the acts which violated the statute caused the injury to petitioner and resulted in profits to the defendants.

The decision of the Circuit Court of Appeals below permits the defendants to retain the fruits of their unlawful conduct and gives no relief to the stockholders injured by that conduct.

Third Cause of Action

The Act enlarged the fiduciary obligations of directors of holding companies and required that they act for the best interests of security holders as envisaged by the Act rather than in the interests of affiliated banking interests who dominated and controlled them. A stockholder in a registered holding company therefore has a right of action against directors who fail to perform the duty imposed upon them by Section 11(e) to file a plan of divestment and

control or for the purpose of bringing the company into compliance with the provisions of Section 11(b), where the holding company is economically unnecessary and renders no services to its system companies.

Jurisdiction

Since Petitioner has a right of action based on violations of Sections 4(a) or (b) or 11(e), the District Court has jurisdiction over the subject matter of the action under Section 25 of the Act and Petitioner was entitled to avail himself of the provisions of that section relating to venue and service of process.

POINT I

The Public Utility Holding Company Act of 1935 gives a stockholder of a holding company a right of action against the directors of such company for damages and profits resulting from their willful acts in causing the company, while unregistered, to own securities and to exchange securities of subsidiary companies in violation of the express prohibitions contained in Section 4(a) of the Act.

A. It was the clear and unequivocally expressed intention of Congress to forbid unregistered holding companies to own or exchange the securities of subsidiary companies or to do any of the other acts expressly proscribed by Section 4(a).

Section 4(a) provides, in part, that "unless a holding company is registered under Section 5, it shall be unlawful for such holding company, directly or indirectly * * * to distribute or make any public offering for sale or exchange of any security of such holding company, any subsidiary

company or affiliate of such holding company, any public utility company or any holding company" or "* * * to acquire or negotiate for the acquisition of any security or utility assets of any subsidiary company" or "to own, control or hold with power to vote any security of any subsidiary companies thereof * * *." It is too clear to require argument that the Congress intended by the foregoing language that no unregistered holding company should do any of the acts so proscribed. Section 29 makes willful violation of Section 4(a) a crime.

B. Under settled principles of law, a private right of action exists for violation of Section 4(a) even though that section does not expressly confer a civil right of action on private parties.

It has long been established that where a statute makes certain conduct unlawful, a person who is of the class intended to be protected and who has sustained damage from acts done in violation of the statute may maintain an action therefor, despite the absence of an express provision in the statute conferring a right of action for such violation. *Texas & Pacific R.R.* v. *Rigsby,* 241 U. S. 33; *Goldstein* v. *Groesbeck, et al.,* 142 F. 2d 422, 427 (C. C. A. 2, 1944), *cert. den.* 323 U. S. 737; *Zajkowski* v. *American Steel & Wire Co.,* 258 F. 9 (C. C. A. 6, 1918); *Armour* v. *Wanamaker,* 202 F. 423 (C. C. A. 3, 1913); *Baird* v. *Franklin,* 141 F. 2d 238, 244-245 (C. C. A. 2, 1944), *cert. den.* 323 U. S. 737; *Narramore* v. *Cleveland, C. C. & St. L. Ry. Co.,* 96 F. 298 (C. C. A. 6, 1899); see *Restatement of Torts,* §§286-288. It is also established that where the directors of a corporation cause it to violate a statute they are themselves liable under the statute, both civilly and criminally,

for their actions in causing such violation. *Northwest Theaters Co.* v. *Hanson,* 4 F. 2d 471 (C. C. A. 9, 1925); *United States* v. *Van Schaick,* 134 F. 592 (C. C.); *People* v. *Knapp,* 206 N. Y. 373, 99 N. E. 841; *State* v. *Frazer,* 105 *Or.* 589, 209 P. 467; see 19 C. J. S. p. 272; 3 *Fletcher Cyclopedia of Corporations,* §1137; cf. *Hitchcock* v. *American Plate Glass Co.,* 259 F. 948 (C. C. A. 3, 1919); *National Cash Register Co.* v. *Leland,* 94 F. 502 (C. C. A. 1, 1899); *U. S.* v. *Snyder,* 14 F. 554 (C. C.).

In *Goldstein* v. *Groesbeck, supra,* a stockholder of American Power & Light Co., which dominated and controlled four subsidiary operating companies, and was itself dominated and controlled by Electric Bond & Share Company, brought a double derivative stockholder's action on behalf of American's four operating companies against Electric Bond & Share, Ebasco Services (a subsidiary service company of Electric Bond & Share) and certain officers and directors of those companies, for an accounting of profits received by Ebasco under service and construction contracts made with the operating companies in violation of Section 4(a)(2) of the Act, while Electric Bond & Share Company was unregistered. Section 4(a) prohibits unregistered holding companies from entering into service or construction contracts with public-utility companies, just as it prohibits unregistered holding companies from owning or exchanging securities of subsidiary companies. In reversing the District Court's dismissal of the action against the defendants, the opinion of the Circuit Court of Appeals expressly rejected the contention that because the proscription of service contracts by Section 4(a)(2) was made as a penalty for failure to register, it followed

that Section 4(a)(2) could not be enforced by a private party, and went on to state that "we think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

In the present case Petitioner, as a stockholder of a public utility holding company, is unquestionably a member of a class which, as Section 1(b) declares, the Act was designed to protect. He was injured by the willful acts of the directors of United in causing United, while unregistered, to own and to exchange the securities of subsidiary companies, in violation of Section 4(a). It is submitted, therefore, that Petitioner has a right of action against the directors of United based on violations of Section 4(a) even though that section does not expressly provide for a civil action.*

C. It was error for the Circuit Court of Appeals to limit the creation of a right of action for violation of Section 4(a) to cases in which the damages result from failure to register under Section 5.

1. *Causing Holding Companies to Register Was Not the Only Purpose of Section 4(a).*

The Circuit Court of Appeals held that the first two causes of action of the Amended Complaint did not state valid claims based on Section 4(a) because they did not allege that the damages complained of resulted from "failure

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* Recovery has been permitted against statute violators even by persons who were not members of a class intended to be protected by such statute. See *Grey's Exec'r.* v. *Mobile Trade Co.*, 55 Ala. 387; cf. *Union Pacific Railway Co.* v. *McDonald*, 152 U. S. 262, 282.

to register'' under Section 5 (R. fol. 152a, Opinion of C. C. A., p. 10). This is a limitation upon the liability which would normally follow from the violation of such a statutory provision, under the principles discussed above. No such limitation was placed upon liability for violation of Section 4(a) by the decision in *Goldstein* v. *Groesbeck, supra.*

Of course, Congress may limit or entirely withhold the right to recover damages resulting from a statutory violation. But, as stated in *Kardon* v. *National Gypsum Company, et al.,* 69 F. Supp. 512, 514 (E. D. Pa.), ''the right is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly or plainly.'' In the present case there is no provision in the Act which either withholds a private right of action for violation of Section 4(a) or limits such right to situations in which the damages caused by such violation resulted from failure to register under Section 5.*

The Circuit Court of Appeals' conclusion as to the existence of such limitation is based on the assumption that the *only* purpose of Section 4(a) was to compel holding companies to register. The only bases for this assumption referred to in the Court's opinion are the decision of this Court in *Electric Bond & Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, 442, and comments in the Reports of the House and Senate Committees with ref-

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* Section 25 of the Act vests the District Court with "jurisdiction of violations of this title * * * and * * * of all suits in equity and actions at law brought to enforce any liability or duty created by * * * this title * * *''

erence to Section 4 (R. fol. 152a, Opinion of C. C. A., p. 5, footnote 18, p. 8).

In the *Electric Bond & Share* case this Court stated that the penalty for failure to register under Section 5 of the Act was the withdrawal from unregistered holding companies of the right to do any of the acts enumerated in Section 4(a). This penalty was incurred, therefore, only if an unregistered company complied with Section 4(a). But if it did not comply, as United did not comply, it did not suffer this penalty. The fact that refraining from doing the acts prohibited by Section 4(a) is the penalty for remaining unregistered is, therefore, entirely irrelevant to a determination of whether Congress intended a private party to have a civil right of action for acts which in fact were done by an unregistered company in violation of Section 4(a). The decision of this Court in the *Electric Bond & Share* case, therefore, lends no support to the assumption that the only purpose of Section 4(a) was to compel registration or the conclusion that Congress intended no right of action or only a very limited right of action for violation of that section. See *Goldstein* v. *Groesbeck, supra,* at p. 427.

The statement in the Committee Reports with reference to Section 4 reads as follows:*

> "SECTION 4. TRANSACTIONS BY UNREGISTERED HOLDING COMPANIES.
>
> This section establishes the mechanism by which holding companies are brought under the jurisdic-

* Sen. Rep. No. 621, 74th Cong. 1st Sess., p. 25; H. R. Rep. No. 1318, 74th Cong. 1st Sess., p. 11.

> tion of the Commission so that the provisions of title I may be effectively administered. That mechanism is registration, and it is made the duty of every holding company, unless exempted, to register by November 1, 1935, if it is to carry on any of the activities which are national in scope and hence of particular concern to the Federal Government. Unregistered companies after that date are prohibited from engaging in these activities unless they are registered."

It is apparent that the foregoing paragraph relates to Section 4 as a whole and not exclusively to Section 4(a). For Section 4(b) made it the duty of every holding company, unless exempted, to register if it was to carry on any of the activities of national scope which were of concern to the Federal Government. See *North American Co. v. Securities and Exchange Commission,* 327 U. S. 686, 697, footnote 8. The fact that the whole section established a mechanism which Congress contemplated would cause holding companies to register is not evidence that the only purpose of subdivision (a) of Section 4 was to compel registration. The "mechanism" of the section was to require all holding companies to register by Section 4(b) and to forbid any company which did not register to do any of the acts enumerated in Section 4(a). The fact that Congress probably contemplated that all companies would register rather than refrain from doing the acts prohibited by Section 4(a) is not persuasive that Congress intended either that no civil liability should attach to acts done by an unregistered company in violation of Section 4(a) or that such liability should be limited to cases in which the damages resulted from failure to register under Section 5.

The whole structure of the Act makes it apparent that Congress intended entirely different types of provisions to apply to unregistered holding companies than applied to registered holding companies. The former were completely prohibited from doing any of the acts enumerated in Section 4(a). The latter were subjected to the supervisory jurisdiction of the Securities and Exchange Commission and were permitted to do all of the acts enumerated in Section 4(a), provided they made the disclosures and complied with the requirements laid down by later sections of the Act and the Commission determined that the particular actions proposed conformed to the standards prescribed for registered holding companies. See *North American. Co.* v. *Securities and Exchange Commission, supra,* at pp. 697-698.

While it is clear that Congress intended that holding companies should register, it is equally clear that it intended that unregistered companies should not do any of the acts expressly prohibited by Section 4(a). The extensive investigations and reports made by the Federal Trade Commission and the House Committee on Interstate and Foreign Commerce, which preceded the passage of the Act, had shown the manifold and complex evils which had resulted from the ownership, acquisition and disposition of the securities of their subsidiaries by unregulated holding companies. These reports dealt at length with the injuries to investors in the securities of unregulated holding companies which had resulted from the management and control of such companies by officers and directors dominated

and controlled by banking concerns whose interests were in conflict with those of the company's stockholders. See Reports of Federal Trade Commission made pursuant to S. Res. 83, 70th Cong., 1st Sess., No. 52, pp. 1-86, 488-602; No. 72A, pp. 111-116, 130-136, 858-870, 880; No. 73A, pp. 61-64; Reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59, 72nd Cong., 1st Sess., and H.J. Res. 572, 72nd Cong., 2nd Sess., Part 2, pp. 94-97, Part 5, pp. 717-751; S. Rep. No. 621, 74th Cong., 1st Sess. (to accompany S. 2796), p. 4. In the present case the Amended Complaint alleges that the reason why the defendant banking interests, through their control of the directors of United, caused United to own the securities of subsidiaries in violation of Section 4(a) was to enable them to continue to realize profits as they had in the past from their control of United and the subsidiary companies in its holding-company system.

Section 1(c) of the Act specifically states, on the basis of the abuses enumerated in Section 1(b), that "the holding company becomes an agency which unless regulated is injurious to investors * * *."

It is submitted that the foregoing makes it abundantly clear that Congress regarded the activities which Section 4(a) forbade to unregistered holding companies as substantive evils in themselves and that the purpose of the prohibition of such activities was not merely to exert pressure on unregistered holding companies in order to cause them to register.

It is therefore submitted that there is no evidence to support the assumption of the Circuit Court of Appeals that the only purpose of Section 4(a) was to compel holding companies to register, or its conclusion that Congress intended that civil liability for violation of Section 4(a) should be limited to cases where the damages resulted from failure to register. To the contrary, the Act's legislative background, entire structure and declaration of policy contained in Section 1 constitute affirmative evidence that Congress intended the normal rule of civil liability to be applied to violations of Section 4(a) without the restrictions imposed by the decision below of the Circuit Court of Appeals.

Moreover, it should be observed that the imposition of normal civil liability for violation of Section 4(a) is not inconsistent with the purpose of causing holding companies to register but is in aid of that purpose. For the imposition of such liability for violation of Section 4(a), in addition to the criminal and injunctive remedies of the Act, gives added weight to the pressure which Section 4(a) was designed to exert in order to cause holding companies to register.

As stated by Circuit Judge (later Chief Justice) Taft in *Narramore* v. *Cleveland, CC. & St. L. Ry. Co., supra,* at p. 300, the fact that a statute expressly provides for criminal prosecution as a mode of enforcement does "not exclude the operation of another, and in many respects more efficacious, means of compelling compliance with its terms, to wit, the right of civil action * * *." Certainly, reliance upon the right of civil action by private citizens as a means of insuring compliance with the law is a heritage of our

Anglo-American jurisprudence which should not lightly be restricted. Nor should it be presumed that the Congress intended to restrict the right to recover the damages which under established principles would normally follow from violations of Section 4(a), in the absence of evidence of any such Congressional intention.

2. *Defendants' Acts in Violation of Section 4(a) Were the Legal Cause of Damage to Petitioner.*

(a) *Section 4(a)(6).*

The Circuit Court of Appeals below held that since the damages complained of were not alleged to have resulted from failure to register, there was no legal connection between the violations of Section 4(a)(6) and the loss to petitioner,* and that the only basis upon which the defendants could be held liable would be that their violation of the statute made them liable as insurers against all harm. As an illustration of this point the Court referred to the case of a motorist who, at the moment of a collision, was violating the law by carrying concealed weapons. In such case, of course, the driver does not become liable to a pedestrian injured without negligence merely because he was violating the law at the time of the accident. The Court pointed out that the criminal conduct in that case was without legal significance, since it had no effect in causing the injury (R. fol. 152a, Opinion of C.C.A., pp. 6, 8, footnote 15, p. 6).

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* As has already been shown, the premise of this argument is unsound.

The foregoing illustration, it is submitted, illuminates the error which led the Court below to an incorrect conclusion, for there is no sound analogy between the illustration given and the facts involved in the present case. In this case, the damage to petitioner did not merely occur, without any causal connection, at the same time that the defendants were committing an unlawful act, but, on the contrary, the damage was caused by the very act which was committed in violation of Section 4(a)(6). If the defendants had not caused United to continue to own the securities of its subsidiaries, United would not have suffered the loss in the value of those securities or incurred the expenses entailed by their continued ownership, and the defendants would not have realized the profits which they did as the result of such ownership. In the illustration given by the Court below, the act which violated the statute did not produce the injury. In the present case, it did.

It is therefore not necessary to hold, as stated by the Court below, that the defendants must be held to be insurers against all harm in order for there to be civil liability in this case. All that is required is that they be held liable for damages which their unlawful acts caused to persons within a class designed to be protected by the statute. See *Restatement of Torts*, §286.

Indeed, assuming *arguendo* that the Circuit Court of Appeals was correct in limiting the right of recovery under Section 4(a) by reference to registration under Section 5, it would still appear that even under such a restricted criterion the First Cause of Action of the Amended Com-

plaint sets forth a valid claim for recovery of the profits realized by the defendants. For it alleges that as a result of causing United to own securities, in violation of Section 4(a)(6), the directors, and affiliated banking interests who controlled them, were enabled to realize profits, as they had in the past, from banking and underwriting business which they obtained through their control over United and its holding company system (R. 34a, 35a). If United had been a *registered* holding company there would have been no assurance of realizing such profits, since under Section 17(c) directors who were members of investment banking firms would have been compelled to resign their directorships,* and underwriting fees would have become subject to scrutiny by the Securities and Exchange Commission under its rule relating to competitive bidding. See Rule U-50 of General Rules and Regulations under the Public Utility Holding Company Act of 1935. It would therefore, appear that even if the Amended Complaint failed to state a valid claim for recovery of the *loss* in value of the securities of subsidiaries owned by United, under the restricted criterion enunciated by the Circuit Court of Appeals below, it still would state a valid claim for the recovery of *profits* realized by the defendants as the result of such unlawful ownership. For there profits were realized because United was unregistered, and therefore unregulated. Section 1(c), as has been seen, specifically de-

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* George E. Whitney, Landon K. Thorne, and Hendon Chubb in fact resigned March 28, 1938, the day that United registered (R. 64a, 65a).

clares that an unregulated holding company is injurious to investors.*

(b) *Section 4(a)(3) and (4).*

In addition to the foregoing considerations, which apply both to violations of Sections 4(a)(6) and 4(a)(3) and (4), the following additional considerations are peculiarly applicable to the exchange of securities effected in violation of Section 4(a)(3) and (4).

Section 9(a)(1) makes it unlawful for any *registered* holding company to acquire any securities in any business unless the acquisition has been approved by the Securities and Exchange Commission under Section 10. Under Section 10(a) a person applying for approval of the acquisition of securities must set forth complete information, on Form U 10-1 pursuant to Rule 10A-1, with regard to the security to be acquired, the consideration to be paid there-

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* See also Section 1(b)(4) which states that the interests of investors in the securities of holding companies are or may be adversely affected "when the growth and extension of holding companies bears no relation to economy of management and operation". As stated by this Court in *North American Co.* v. *Securities and Exchange Commission, supra,* at p. 703:

> "The 'growth and extension of holding companies' obviously rest upon their security holdings."

The opinion of the Court further pointed out (at pp. 701-704 706, 710) that the ownership of securities of subsidiaries was the most important single factor in the existence and operation of holding companies, giving rise to a multitude of evils and abuses. It is the number and complexity of the hazards which result from violation of Section 4(a) which differentiates that section from the simpler statutes involved in the cases referred to in the opinion below of the Circuit Court of Appeals (R. fol. 152a, Opinion of C. C. A., p. 6, footnote 14). Section 4(a) was not directed against only one specific hazard, as were the statutes in those cases.

for, a description of the rights and privileges of all securities of the company whose security is to be acquired, options in respect of any such securities, the names of all security holders owning more than 1% of any class of securities of such company, balance sheets and profit and loss statements, and all other pertinent information. Under Section 10(b) the Commission approves the acquisition unless it finds that it will tend toward interlocking relations or concentration of control detrimental to the interest of investors or that the consideration paid in connection with such acquisition is unreasonable or that such acquisition will unduly complicate the holding company system and be detrimental to the interest of the investors. Section 10(c) provides that notwithstanding the provisions of Section 10(b), the Commission shall not approve an acquisition of securities which is detrimental to the carrying out of the provisions of Section 11 or the acquisition of securities of a public utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending toward the economic development of an integrated public utility system. Section 10(e) empowers the Commission to condition its approval of an acquisition upon such terms and conditions, including the price to be paid for such securities, as it may find necessary or appropriate for the protection of investors.

Section 12(d) makes it unlawful for any *registered* holding company to sell any security of any public utility company in contravention of the Commission's rules regarding consideration, fees, disclosure of interest, and similar matters. Section 12(e) makes the solicitation of proxies or consents regarding any security of a subsidiary company

unlawful if made in contravention of the Commission's rules and regulations. Section 12(f) makes it unlawful for any *registered* holding company or subsidiary to enter into any transaction, not otherwise unlawful, with any company in the same holding company system, in contravention of the Commission's rules regarding financial information disclosure of interest and similar matters. Section 12(g) contains corresponding provisions with respect to any affiliate of any public utility company or of any registered holding company or subsidiary.

By causing United to remain unregistered, the defendants deprived the stockholders of United of the protection which they would have received from the foregoing sections if United had been a registered holding company. If the exchange of stock involved in the Mohawk-Niagara merger had been subjected to the requirements of full disclosure and Commission scrutiny and approval, the transaction might never have been consummated and the consequent loss to the stockholders of United might never have occurred. The Second Cause of Action does not and could not allege as a fact what action the Commission would have taken under Sections 9, 10 and 12 if United had been a *registered* holding company. This is obviously unnecessary since United was an unregistered company, and the cause of action is based on violations of Section 4(a)(3) and (4), which applies only to unregistered companies. But the action of the Congress in prohibiting *registered* companies from distributing, exchanging or acquiring securities except in conformity with the exhaustive protective provisions embodied in Sections 9, 10 and 12, gives added emphasis to the fact that the actions of holding companies in effec-

tuating such transactions without the safeguards provided by those sections was one of the evils against which the Act was designed to protect investors. This gives further support to the conclusion that Section 4(a)(3) and (4) was intended to give an investor in the securities of a holding company a right of action for damages resulting from transactions consummated in violation of that section.

The violations of Section 4(a)(3) and (4) fit, in every particular, the criteria set forth in Section 286 of the Restatement of Torts as to when a violation of a statute gives rise to a civil liability. According to that section, a violation of a statute creates civil liability to an individual when (1) the intent of the statute is exclusively or in part to protect the interest of the individual, (2) the interest invaded is one which the statute is intended to protect, (3) where the statute is intended to protect an interest from a particular hazard, the invasion of the interest results from that hazard, and (4) the violation is a legal cause of the invasion. In the present case (1) the intent of the Act is in part to protect investors in the securities of holding companies, such as Petitioner, (2) the interest of such investors in the value of securities of subsidiaries owned by such holding companies is an interest which the Act is intended to protect, (3) the Act is intended to protect them from the hazard of unregulated distributions, acquisitions and exchanges by holding companies of the securities of subsidiary companies, and the invasion of plaintiff's interest resulted from that hazard, and (4) the distribution, acquisition and exchange of securities of subsidiaries of United in violation of the Act is the legal cause of the invasion of Petitioner's interest.

3. *The Limitation of Liability Imposed by the Decision of the Circuit Court of Appeals Allows the Defendants to Retain the Fruits of Their Unlawful Conduct and Gives No Relief to the Stockholders Injured by That Conduct.*

As alleged in the Amended Complaint, the defendants caused United to remain an unregistered company but to perform acts which Section 4(a) expressly forbade such a company to do. By following this course of action, the defendants perpetuated the operations of an unregulated holding company which contributed "nothing" to the normal functioning of the companies in the United holding-company system, which was "economically unnecessary," and which "unduly and unnecessarily" complicated the holding-company system and at the same time assured themselves of a continued "source of underwriting profits and fees" through the domination and control which they continued to maintain over that system through United's ownership of the securities of its subsidiary companies. The stockholders of United "paid a price" for the continued "unnecessary corporate existence" of United and the appropriate remedy for this situation was, as stated by the Securities and Exchange Commission, "dissolution."* The defendants thus continued to enjoy, at the expense of the stockholders of United, the fruits of their domination and control over the United holding-company system as freely as if the Public Utility Holding Company Act of 1935 had never become law. When, as has been shown, cer-

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* The quoted language is from the Findings and Opinion of the Commission, *In the Matter of The United Corporation*, file Nos. 54-33, 59-25, Holding Company Act of 1935, Release No. 4478 dated August 16, 1943 at pp. 8, 27, 28, 43 and 50, 13 S. E. C. 854, at pp. 859, 860, 864, 876, 877, 892, 893 and 899.

tain of the acts of the defendants were unlawful and resulted in damage to the stockholders of United and profits to the defendants, there is no reason why the defendants should not be held civilly liable for their actions, under the established principles of law which have previously been set forth. For, as stated by the Court in *Goldstein* v. *Groesbeck, supra,* at page 427:

> "When the defendants decided to ignore this legislation as unconstitutional, they surely took the risk of answering over to their own stockholders as to the propriety of their action."

POINT II

Section 11(e) imposes a duty upon the directors of an economically unnecessary holding company, which renders no services to its system companies and whose structure does not conform to the standards of Section 11(b), to file a plan of divestment of control, or for the purpose of bringing the company into compliance with the provisions of Section 11(b). A stockholder in such a company has a right of action against directors who fail to perform this duty.

Section 4(b) provides that every holding company with outstanding securities, any of which were distributed through the mails or instrumentalities of interstate commerce subsequent to January 1, 1925 and any of which were owned by non-residents of the State of the company's incorporation on October 1, 1935, "shall register under section 5 on or before December 1, 1935." As alleged in the Third Cause of Action, the defendants caused United to

fail to register from December 1, 1935 to March 28, 1938, in violation of Section 4(b). On the latter date it registered.

Section 11(e) authorized any registered holding company, at any time after January 1, 1936, to submit a plan to the Securities and Exchange Commission for the divestment of control or securities, or for other action to enable the company to comply with the provisions of Section 11(b). The defendants caused United to take no action under Section 11(e) until March 4, 1941, when United filed an alleged "plan" which was disapproved by the Commission in an order which directed United to change its capitalization to one class of stock and to cease to be a holding company. The defendants nevertheless caused United to continue to own well over 10% of the stock of its four subsidiaries. The defendants acted in this manner for purposes of their own profit, with resulting damage to the stockholders of United and profits to themselves.

It is Petitioner's position that it was the duty of the directors and officers of United, under the foregoing sections, to take advantage of the beneficial provisions of the Act by causing United to register and submit itself to the protective regulations of the Act and, after it registered, to submit to the Commission a *bona fide* plan designed to simplify the company's corporate structure and limit the operations of the holding-company system to a single integrated public-utility system, in accordance with the provisions of Section 11(b) and (e). Instead of doing this, they continued, after United had registered as they had previously, to resist and oppose the purposes of the Act designed to protect the interests of investors, in order that J. P. Morgan & Co., Inc., Thorne, Loomis & Co. Inc.,

Thorne, Loomis and other defendants in the banking business might continue to realize profits from the banking and underwriting business they received from United and its subsidiaries.

While this action could not have been legally improper prior to the existence of the Public Utility Holding Company Act of 1935, it is submitted that the enactment of that statute enlarged the fiduciary obligations of the defendants and required that they act for the best interests of security holders as envisaged by the Act rather than in the interests of the affiliated banking interests who dominated and controlled United. One of the major aims of the Act was to eliminate this conflict of interest on the part of directors of holding companies, which experience had shown was injurious to the interests of investors in holding company securities.* In the present case, as alleged in the Third Cause of Action, this same conflict of interest has nevertheless resulted in profits to affiliated banking interests and damage to investors, even after the passage of the Act and the registration of United thereunder. It is submitted that Petitioner, an injured investor, has a right of action against the defendants, whose violations of the fiduciary duties imposed by the Act brought profits to themselves and caused damage to Petitioner.

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* See Reports of Federal Trade Commission and House Committee on Interstate Commerce referred to above at p. 29.

Conclusion

If, as has been shown, the Petitioner has a right of action based on violations of Sections 4(a) or (b) or 11(e), the District Court has jurisdiction over the subject matter of the action* under Section 25 of the Act, and Petitioner was entitled to avail himself of the provisions of that section relating to venue and service of process. It was therefore error for the Circuit Court of Appeals below to affirm the dismissal of the action for lack of subject matter jurisdiction.

Respectfully submitted,

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* Even if the facts alleged in the Amended Complaint also constitute grounds for relief at common law, a federal district court has jurisdiction over the action. *Hurn* v. *Oursler*, 289 U. S. 238; *Armstrong Paint & Varnish Works* v. *Nu-Enamel Corp.*, 305 U. S. 315.

APPENDIX

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Necessary for Control of Holding Companies

Section 1. (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

TRANSACTIONS BY UNREGISTERED HOLDING COMPANIES

SEC. 4. (a) After December 1, 1935, unless a holding company is registered under section 5, it shall be unlawful for such holding company, directly or indirectly—

(1) to sell, transport, transmit, or distribute, or own or operate any utility assets for the transporta-

tion, transmission, or distribution of, natural or manufactured gas or electric energy in interstate commerce;

(2) by use of the mails or any means or instrumentality of interstate commerce, to negotiate, enter into, or take any step in the performance of, any service, sales, or construction contract undertaking to perform services or construction work for, or sell goods to, any public-utility company or holding company;

(3) to distribute or make any public offering for sale or exchange of any security of such holding company, any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company, by use of the mails or any means or instrumentality of interstate commerce, or to sell any such security having reason to believe that such security, by use of the mails or any means or instrumentality of interstate commerce, will be distributed or made the subject of a public offering;

(4) by use of the mails or any means or instrumentality of interstate commerce, to acquire or negotiate for the acquisition of any security or utility assets of any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company;

(5) to engage in any business in interstate commerce; or

(6) to own, control, or hold with power to vote, any security of any subsidiary company thereof that does any of the acts enumerated in paragraphs (1) to (5), inclusive, of this subsection.

(b) Every holding company which has outstanding any security any of which, by use of the mails or any means

or instrumentality of interstate commerce, has been distributed or made the subject of a public offering subsequent to January 1, 1925, and any of which security is owned or held on October 1, 1935 (or, if such company is not a holding company on that date, on the date such company becomes a holding company) by persons not resident in the State in which such holding company is organized, shall register under section 5 on or before December 1, 1935 or the thirtieth day after such company becomes a holding company, whichever date is later.

SEC. 11(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wher-

ever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

JURISDICTION OF OFFENSES AND SUITS

SEC. 25. The District Courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347), and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893 (D. C. Code, title 18, sec. 26). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

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IN THE

Supreme Court of the United States

October Term, 1947
No. 365

EDWARD R. DOWNING, suing on his own behalf and on behalf of all other stockholders of THE UNITED CORPORATION (of Delaware), etc.,

Petitioner,

against

GEORGE H. HOWARD, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONER

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IN THE

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SCOPE OF REPLY BRIEF

This brief will be confined to replying to defendants' principal contentions,* which may be summarized as follows:

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* For convenience, the Brief In Behalf of Respondents Howard, Chubb, *et al.*, submitted by William S. Potter, Esq., will be referred to as the "Potter Brief," the Brief for Defendants Edward Hopkinson, Jr. and Others, submitted by Ralph M. Carson, Esq., will be referred to as the "Carson Brief," and the Brief for the Defendants Thorne and Others, submitted by Caleb S. Layton, Esq., will be referred to as the "Layton Brief."

1. That Petitioner's claims are based on breach of "common law" fiduciary duties and not on breach of duties created by the Public Utility Holding Company Act of 1935.

2. That the decision of the Circuit Court of Appeals below is not in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Goldstein* v. *Groesbeck, et al.*

3. That it should not be presumed that Congress intended to confer a private right of action for violation of Section 4(a).

4. That the decision of the Circuit Court of Appeals below involves merely a construction of the Amended Complaint rather than an interpretation of the Act.

5. That "lack of registration" rather than owning and exchanging securities, was the "illegal aspect" of defendants' violations of Section 4 (a).

POINT I

The defendants' contention that petitioner's claims are based on breach of "common law" fiduciary duties and not on breach of duties created by the Public Utility Holding Company Act of 1935.

This is the same point which defendants unsuccessfully urged before the Circuit Court of Appeals below as a ground for dismissing the action. There is no reason why the Amended Complaint must be based *either* on common law *or* on the Act. To the contrary, it is almost inevitable that a valid claim against the directors of a holding company based on their violations of the Act will also, under a liberal construction of the pleadings, set forth a valid claim against them at common law or in equity. Even if the conclusionary allegations to which the defendants give such exaggerated emphasis* may be deemed sufficient to cause the Amended Complaint to state valid claims at common law, the Court will look at the complaint in its entirety and grant the plaintiff whatever relief the facts set forth entitle him to. *Truth Seeker Co.* v. *Durning*, 147 F. 2d 54, 56 (C. C. A. 2, 1945); *Cohen* v. *Randall*, 137 F. 2d 441, 442-443 (C. C. A. 2, 1943); *Atwater* v. *North American Coal Corporation*, 111 F. 2d 125, 126 (C. C. A. 2, 1940); see 1 *Moore's Federal Practice*, 1946 Supp., 219. It is settled by decisions of this Court that where the same set of facts alleged in a complaint constitutes grounds for relief both at common law and under a federal statute, a federal district court has jurisdiction over the subject matter of the action. *Hurn* v. *Oursler*, 289 U. S. 238; *Armstrong Paint &*

* See Potter Brief, pp. 3-5.

Varnish Works v. *Nu-Enamel Corp.*, 305 U. S. 315. As correctly stated by the Court below (162 F. 2d 654, at p. 655):

> "It is apparent that the question which we have to settle is whether the plaintiff has stated a basis for recovery under the federal statute just mentioned. If he has, the fact that he also asserts a non-federal ground does not lose him his privilege of suing in the federal court."

The statements in the Carson Brief (at pp. 5-9) to the effect that Petitioner contends that his right of action under the Act is based upon an "enlarged * * * fiduciary obligation" of directors not to act for the benefit of interests in conflict with the interests of stockholders, is a demonstrably incorrect statement of Petitioner's position, which serves only to obscure, rather than to clarify, the issues presented by this case. The quoted language, which the Carson Brief takes out of its context, related solely to Petitioner's "Third Cause of Action", which dealt with defendants' failure to file a plan under Section 11(e) of the Act (See Brief for Petitioner, pp. 20, 41). No such argument was even suggested as to the first two causes of action, which are clearly based on breach of the express statutory prohibitions against owning and exchanging securities, contained in Section 4(a).

POINT II

The defendants' contention that the decision of the Circuit Court of Appeals below is not in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Goldstein v. Groesbeck, et al.*

Apparently, the reason the Carson Brief sought to obscure the true basis of Petitioner's position was to lay the foundation for attempting to distinguish the case of *Goldstein* v. *Groesbeck, et al.*, 142 F. 2d 422 (C. C. A. 2, 1944), *cert. den.* 323 U. S. 739. As stated in that brief (at p. 9), the Amended Complaint in this case is based on "alleged violation of pre-existing equitable duty," whereas, as stated in the opinion in *Goldstein* v. *Groesbeck* (at p. 425), that action was "surely to enforce a duty created by the Act, since but for the Act the payment under the service and construction contracts would be innocuous enough."

But, as has been shown, the first two causes of action of the Amended Complaint are based on owning and exchanging securities in violation of Section 4(a), just as in *Goldstein* v. *Groesbeck* the complaint was based on service and construction contracts made in violation of that section. And, as in that case, the acts of owning and exchanging securities were entirely lawful prior to the passage of the Act.* It may therefore be stated in this case, as in *Gold-*

* The investigations by the Federal Trade Commission and Congressional Committees which preceded the passage of the Act had shown the social undesirability of many of the corporate relations and practices of public utility holding companies and that the then existing remedies at common law and under state statutes were inadequate to cope with them. See *Reports of Federal Trade Commission*, made pursuant to S. Res. 83, 70th Cong., 1st Sess., No. 69A, p. 357; No. 73A, pp. 1-28. But it was only upon the passage of the Act that these relations and practices became wrongful as a matter of law.

stein v. *Groesbeck,* that "but for the Act" the acts complained of "would be innocuous enough."

The Layton Brief (at pp. 14, 15) attempts to distinguish the *Groesbeck* case on the further ground that the service and construction contracts there made in violation of Section 4(a) were declared void by Section 26 of the Act, and that it therefore followed that the operating subsidiaries which paid money pursuant to such contracts had to be placed in *statu quo.* It is submitted that any such attempted distinction is without substance since Section 26 does no more than enunciate the common law rule that contracts made in violation of an express statutory provision are void (*Williston on Contracts,* Revised Edition, 1936, §1789, p. 5086) and it is therefore apparent that the Court would have reached the same result even without Section 26. Furthermore, it is to be noted that Section 26, like Section 4(a), contains no provision expressly conferring a right of action upon a private party.

The decision in *Meyer* v. *Kansas City Southern R. Co.,* 84 F. 2d 411 (C. C. A. 2, 1936), referred to at page 9 of the Carson Brief, has no application to the facts of this case since there it was clear that the anti-trust acts, and other federal statutes alleged to have been violated, gave a stockholder such as the plaintiff in that case no right to relief against the defendant directors and conferred no jurisdiction upon a federal district court to entertain such an action. See *Meyer* v. *Kansas City Southern R. Co., supra,* at p. 413. In the instant case Section 25 of the Act expressly confers jurisdiction on the District Courts over "all suits in equity and actions at law brought to enforce any duty or liability created by * * * this title." As con-

trasted with the broad jurisdictional provisions of Section 25, the provisions of the anti-trust acts relating to the bringing of actions are extremely limited and restricted. See Section 4 of the Sherman Act (15 U. S. C. A. §4) and Sections 4 and 16 of the Clayton Act (15 U. S. C. A. §§15 and 26). It should also be noted that an investor in the securities of a railroad company was not a member of a class of persons intended to be protected by those statutes, which were primarily intended for the protection of shippers, purchasers of goods in interstate commerce and the public at large. In the present case, however, Petitioner, as an investor in holding company securities, is indisputably a member of a class which the Act was designed to protect.

POINT III

The defendants' contention that it should not be presumed that Congress intended to confer a private right of action for a violation of Section 4(a).

As pointed out at pages 22 and 23 of Petitioner's Brief, it has long been settled, contrary to defendants' contention, that it *is* to be presumed that Congress intends to confer a private right of action for violation of a statutory provision even though the statute does not expressly confer a private right of action for violation of such provision.

The Carson Brief (at p. 9) argues, however, that since Congress expressly provided a private civil remedy for violations of Sections 16 and 17(b) of the Act, it should be presumed that no right of action was intended for violations of Section 4(a). This argument ignores the fact that

both the House and Senate Committee Reports clearly show that it was necessary to define with precision the extent of rights of action under these particular sections in order to avoid conflict with the corresponding sections of the Securities Exchange Act of 1934.* It also fails to take into account the express provision in Section 16(b) to the effect that "the rights and remedies provided by this title, except as provided in Section 17(b), shall be *in addition to any and all other rights and remedies* that may exist under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934 *or otherwise at law or in equity* * * *" (Italics supplied.) Furthermore, this is the type of argument described by the maxim *expressio unius est exclusio alterius* which, as this Court has recently stated, has "long been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose." See *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344 at pp. 350-351. When one considers the broad purposes of the Act to protect investors in the securities of holding companies from injuries resulting from the activities of unregulated holding companies, it becomes apparent that express reference to a civil right of action in certain limited situations was not intended to exclude the maintenance of civil actions in all other situations. Cf. *Kardon* v. *National Gypsum Company, et al.*, 69 F. Supp. 512, at p. 514 (E. D. Pa.).

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* See Senate Report No. 621, Pub. Utility Act of 1935, 74th Cong., 1st Sess., pp. 40-41; House Report No. 318, Pub. Utility Act of 1935, 74th Cong., 1st Sess., p. 21.

POINT IV

The defendants' contention that the decision of the Circuit Court of Appeals below involves merely a construction of the Amended Complaint rather than an interpretation of the Act.

As stated in the Potter Brief (at p. 6), "the Court's decision involved merely a construction of this particular complaint rather than an interpretation in any fundamental sense of the Public Utility Holding Company Act of 1935." To the contrary, it is submitted that the question before the Court was whether a correct interpretation of the Public Utility Holding Company Act of 1935 did or did not give Petitioner a right to relief against the defendants based upon the unequivocal allegations contained in the Amended Complaint. Under the construction of the Act contended for by Petitioner, the Amended Complaint clearly set forth valid claims for relief. Under the interpretation placed upon the Act by the Circuit Court of Appeals below, it did not. The decision of the Circuit Court of Appeals, therefore, necessarily turned upon the proper interpretation of the Public Utility Holding Company Act of 1935—not upon the proper interpretation of the Amended Complaint.

If the Circuit Court of Appeals was right in holding that the Amended Complaint failed to state valid claims for relief under the Act, it was right because its restricted interpretation of the extent to which the Act was intended to impose civil liability was correct. If, on the other hand, Petitioner is right in his interpretation of the Act, it is clear that the Amended Complaint sets forth valid claims for recovery under the Act.

POINT V

The defendants' contention that "lack of registration", rather than owning and exchanging securities, was the "illegal aspect" of defendants' violations of Section 4(a).

It is only in the Layton Brief (pp. 10-13) that the defendants attempt to meet, rather than to avoid or obscure, the basic and important question of statutory interpretation involved in this case. The defendants there argue that since Section 4(a) forbade a holding company to own or exchange securities "unless registered", the "essence of the offense" is failure to register, and a valid claim for violation of Section 4(a) must therefore allege that the damages complained of resulted from "failure to register", as held by the Circuit Court of Appeals below. In addition to the answer to this argument set forth at pages 24-39 of Petitioner's Brief, the attention of the Court is respectfully directed to the following considerations.

Upon the passage of the Act the defendants had a choice between causing United to become a registered holding company or causing it to remain unregistered. If United registered, it and the defendants became subject to the provisions of the Act relating to registered holding companies and their officers, director and affiliates. If United remained unregistered, it was forbidden to own or exchange securities or to do any of the other acts prohibited by Section 4(a). Rather than submit to the consequences to their domination over United and the entire holding-company system which they feared would result from becoming a registered holding company, the defendants decided to cause United

to remain unregistered, but to continue to operate in violation of the express prohibitions of Section 4(a). It was the defendants' own choice. Having chosen to have United remain unregistered, United became subject to the prohibitions of Section 4(a) applicable to unregistered holding companies.

The defendants then argue (Layton Brief, p. 11) that Section 4(a) made it unlawful for United to sell the securities of its subsidiaries as well as for it to continue to own them. Assuming that this is so,* it is submitted that this constitutes no reason to relieve the defendants of civil liability for the damages which in fact resulted from their

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* It is not clear that this assumption is correct. Although selling and distributing securities as an incident to the continued operation of United would undoubtedly have constituted a violation of Section 4(a)(3), it is open to question whether a distribution to its stockholders of the securities of its subsidiaries as a step in the termination of its operations would properly be construed as a violation of that section. Viewed against the background of abuses of unregulated holding companies which Congress was attempting to eliminate, it would appear that the sales of securities intended to be proscribed were only those effectuated as part of the continued operation of an unregistered holding company employing the mails and the instrumentalities of interstate commerce, and not those sales or distributions effectuated as an incident to going out of business. This conclusion is strongly reinforced by the fact that it would have been impossible for a large holding company, such as United, to continue in business if it refrained from doing all the acts proscribed by Section 4(a). In this connection it may be noted that Section 7(a) of the Investment Company Act of 1940 (54 Stat. 847, 15 U. S. C. A. §80a-7), which parallels Section 4(a) of the Public Utility Holding Company Act of 1935, expressly states that its provisions "shall not apply to transactions which are merely incidental to the dissolution of an investment company." In the light of the similar structure of the two statutes, it would appear that the foregoing provision in the Investment Company Act of 1940 merely makes explicit what was implicit in both acts even without that provision.

unlawful action in causing United to continue to own securities in violation of Section 4(a). Having embarked upon an unlawful course of action, the defendants acted at their peril. The dilemma in which they found themselves, as the result of causing United to remain unregistered, was of their own making.

Conclusion

The basic question presented by this case is the extent to which the Public Utility Holding Company Act of 1935 creates civil liability for violations of Section 4(a). The determination of this question necessarily involves a determination as to the correct construction and interpretation of that section. Under the established doctrine of *Texas & Pacific R.R. Co.* v. *Rigsby*, 241 U. S. 33, as applied to violations of Section 4(a) by the Circuit Court of Appeals for the Second Circuit in *Goldstein* v. *Groesbeck, et al.*, the first and second causes of action of the Amended Complaint set forth valid claims for damages against the defendants in this case. Under the restricted interpretation placed upon Section 4(a) by the Circuit Court of Appeals below, the first two causes of action fail to state such valid claims.

The determination of which rule of interpretation is correct, or whether some other standard of interpretation is applicable, involves an important question of interpretation of a federal statute, which is of general importance to members of the public as well as to the thousands of stockholders of The United Corporation. As alleged in the

Amended Complaint, the defendants in this case willfully violated a statute whose language was unequivocal and whose intention to prohibit the acts complained of was clear. The only question which was not clear was the extent to which the defendants might be held answerable for their actions in a civil suit. In determining the extent to which civil liability should be imposed, it is submitted that this Court should properly give application to its pronouncement in the case of *U. S.* v. *United Mine Workers*, 67 S. Ct. 677, at p. 705:

> "The greater the power that defies the law the less tolerant can this Court be of defiance."

Respectfully submitted,

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WILLIAM H. BENNETHUM,
JOHN F. DAVIDSON,
of Counsel.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 194 7

No. 365

EDWARD R. DOWNING, etc.,
Petitioner,

against

GEORGE H. HOWARD, et al.,
Respondents.

BRIEF IN BEHALF OF RESPONDENTS HOWARD, CHUBB, STACY, STURGES, BURNS, LUCKETT, FERGUSON, BURR, O. K. ANDERSON, DUMAINE, HICKEY AND SMITH, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Statement

This is a derivative action brought by a stockholder of The United Corporation seeking to recover as against former and present officers and directors, and third persons allegedly acting in conspiracy with them, damages for alleged waste of corporate assets and an accounting for alleged profits.

NOTE: All references to the record before the Court below, and to the record of the further proceedings in the Court below, are in page numbers. Unless otherwise noted, italics in quoted matter are supplied.

The amended complaint, filed August 14, 1945, alleged three causes of action (R. 11a, 39a, 48a). Federal jurisdiction of the subject matter, as well as personal jurisdiction of all but three of the individual defendants and the venue of the action, was based and depends solely upon Section 25 of the Public Utility Holding Company Act [15 U. S. C. A. § 79y] (R. 3a-8a, 12a, 39a, 48a). This is conceded by the petitioner (Petition, p. 2),

As the record below shows (R. 71a-101a), the respondents' several motions to dismiss in the District Court raised primarily the question as to the existence of the claimed Federal jurisdiction under Section 25 of the Public Utility Holding Company Act. The District Court decided this question against the petitioner's claim and granted the respondents' motions to dismiss on the ground that the Court lacked jurisdiction over the subject matter of the action (R. 126a, 144a). The Circuit Court of Appeals in its opinion, filed June 24, 1947, reported in 162 F. (2d) 654, likewise decided this question against the petitioner's claim and unanimously affirmed the judgment of dismissal entered in the District Court (R. foll. 152a).

ARGUMENT

POINT I

The Circuit Court of Appeals correctly decided that the amended complaint failed to show a basis for recovery under the Public Utility Holding Company Act and that, in consequence, the claimed jurisdiction herein based on Section 25 of the Act did not exist.

Despite the "highly unusual position" taken by the plaintiff in the Court below that "his general claim for mismanagement does not state a cause of action at all" (R. foll. 152a, p. 2), the fact remains that the plaintiff's claims against the individual defendants are based essentially upon

express allegations of breach of common law "fiduciary" duties as officers and directors, or negligence in the performance of those duties. The blanket allegations in the amended complaint as to "violations" of the Public Utility Holding Company Act by the Corporation are superimposed upon these essential allegations merely to give a semblance of Federal jurisdiction in the matter. They have no legal relation to the causes of action attempted to be alleged in the amended complaint or to the relief therein sought.

In the first cause of action alleged against former officers and directors, the plaintiff, after reciting the failure of the Corporation to register as a holding company under the Act during the period from December 1, 1935 to March 28, 1938, and the retention by the Corporation of certain portfolio securities during that period in "violation" of Section 4(a) of the Act (R. 29a-30a), states in Paragraph THIRTY-EIGHT (R. 32a) that such acts and omissions——

> "were committed in furtherance of a fraudulent conspiracy by the defendants to waste and dissipate the assets of United and to profit at the expense of United by means of said acts and failures to act. In taking part in said conspiracy and the fraudulent acts and omissions pursuant thereto the directors of United conducted themselves in wrongful violation of their fiduciary duties to United and the other defendants knowingly participated in and wrongfully induced such breach of fiduciary duty."*

* The amended complaint (R. 32a-36a) then goes on to state that the "conspiracy to profit at the expense of United included, as an essential element thereof, the continued ownership and holding by United of the aforesaid securities of the subsidiaries"; to claim certain relationships between the officers and directors of United and certain third parties alleged to have acted in conspiracy with them; and to claim damages measured by the difference between the market value of the securities as of December 1, 1935 (when non-exempt holding companies were required to register under the Act) and the market value of the securities as of March 28, 1938 (when United registered as a holding company under the Act).

In the second cause of action alleged against former officers and directors, the plaintiff, after referring to the Corporation's exchange of certain securities in 1937 in connection with the Niagara Hudson Power Corporation-Mohawk Hudson Power Corporation consolidation, in "violation" of Section 4(a) of the Act (R. 40a-42a), states in Paragraphs FIFTY-FOURTH-FIFTY-FIFTH (R. 43a) that such acts and failures——

> "were committed in furtherance of a fraudulent conspiracy among the defendants to waste and dissipate the assets of United and to profit at the expense of defendant United, by means of said acts and failures to act."

and that, by such acts and failures, the individual defendants who were officers and directors of United——

> "committed a breach of their fiduciary duties to defendant United, and were guilty of gross negligence in the discharge of said duties."*

In the third cause of action alleged against all the defendants, including the present officers and directors of the Corporation and those individuals who became officers or directors on and after March 28, 1938, when United registered as a holding company under the Act (R. 29a), the plaintiff, after asserting that United retained certain portfolio securities from January 1, 1936 to 1944 and failed to file with the Securities and Exchange Commission a proper plan for the divestment of securities in "violation" of Section 11 of the Public Utility Holding Company Act (R. 51a-55a), states in Paragraph SEVENTY-EIGHTH (R. 55a) that such acts——

> "constituted gross negligence and a fraudulent breach of their fiduciary duties as directors and

---

* The amended complaint (R. 43a-45a) attempts to spell out, on the basis of a comparison of subsequent declines in the market value of securities, alleged losses suffered by United as a result of the exchange of portfolio securities in connection with the aforesaid consolidation.

officers of said defendant, United. The other defendants knowingly participated in and induced said breach of fiduciary duty by said directors."*

Thus, a mere reading of the complaint shows that the Circuit Court of Appeals correctly decided that the plaintiff had failed to show a basis for recovery under the Public Utility Holding Company Act and that, in consequence, the claimed jurisdiction of the subject matter based on Section 25 of the Act did not exist. Not only is there no basis whatever for the plaintiff's claim that the Corporation's failure to file a proper plan for divestment of securities constituted a violation of Section 11(e) of the Act [15 U. S. C. A. § 79k] (see *American Power & Light Co.* v. *SEC*, 329 U. S. 90, 119, 123, 67 S. Ct. 133, 149, 151 (1946); *Commonwealth & Southern Corp.* v. *SEC*, 134 F. (2d) 747 (C. C. A. 3rd, 1943)); but it is obvious, in view of the claims asserted in the amended complaint, that the alleged "violations" of Section 4(a) of the Act attributable to the Corporation's failure to comply with the registration provisions of the Act, were not the proximate cause of the losses for which the plaintiff seeks redress and, accordingly, afford no ground for federal jurisdiction herein (see *Herrmann* v. *Edwards*, 238 U. S. 107, 35 S. Ct. 839 (1915); *Meyer* v. *Kansas City Southern Ry. Co.*, 84 F. (2d) 411 (C. C. A. 2nd, 1936) *cert.* denied 299 U. S. 607, 57 S. Ct. 233 (1936)).

Moreover, with the failure of jurisdiction over the subject matter based on Section 25 of the Act, personal jurisdiction based on the same Section is also lacking and the venue of this action is clearly improper as to all of the individual defendants who were not served with process within the District of Delaware, and are not residents or inhabitants

* In this instance, the damages are vaguely stated (R. 60a) to be "at least in sums equal to the difference between the value of such shares of stock at the time when this court determines they should have been disposed of, and the present value thereof."

of that District (see Rule 4, Federal Rules of Civil Procedure [28 U. S. C. A. foll. § 723(c)]; Section 51 of the Judicial Code [28 U. S. C. A. § 112].

POINT II

This case does not present any question appropriate for this Court to review.

As appears from Judge Goodrich's opinion below (R. foll. 152a), the Circuit Court of Appeals' decision of affirmance was based primarily upon its determination that the allegations of the complaint were insufficient to establish a causal relation between the damages for which recovery was sought and the "violations" of the federal statute in question. Thus, the Court's decision involved merely a construction of this particular complaint rather than an interpretation in any fundamental sense of the Public Utility Holding Company Act of 1935.

The Circuit Court of Appeals did not, as the petitioner suggests throughout his petition and supporting brief, rule, expressly or by implication, that the failure of a public utility holding company to comply with the registration provisions of the Act could not be made the basis of a private right of action under the Act. On the contrary, this question was left open and the existence of such private right of action was assumed by the Court in determining whether or not the amended complaint stated a basis for recovery under the Act.

In the concluding paragraph of his opinion, Judge Goodrich said (R. foll. 152a, p. 9):

> "Our conclusion is, with regard to plaintiff's first and second claimed causes of action, that we need not commit ourselves on the question whether violation of registration requirements may in some circum-

> stances be made the foundation of assertion of private rights. We shall answer that question when a case compels us to do so. It is sufficient to say that such circumstances are not here presented by the plaintiff. We think that here, even if the violation of the statute could be made the basis of recovery, this plaintiff has not, even when we take all his allegations as true, brought himself into the area of recovery. * * *"

The Petition Misstates the Questions decided by the Circuit Court of Appeals

The principal defect in the petition for certiorari is in its incorrect statement of the questions presented to the Court. It will be noted that the petition (pages 10-11) defines each of the three questions upon which review is sought as involving "damages and profits *resulting from their* [the individual defendants'] *actions in wilfully causing such company while unregistered* * * * " to do or fail to do certain things. Such phrasing, we think, may be calculated to circumvent the only issue considered and decided by the Circuit Court of Appeals. It was the confusion of the allegations on the point of causation which led the Circuit Court of Appeals very carefully to limit its decision in this case. This confusion is now sought to be injected into the pending petition. The Circuit Court held only that *the complaint contained no allegations which, if true, would establish that the loss or damage complained of was caused by or resulted from the claimed violations by the Corporation of the Holding Company Act.*

The Court summarized this basic defect of the complaint as follows (R. foll. 152a, pp. 7-8):

> "* * * It [United] would still have held the shares. The plaintiff does not, nor could he, allege that the shares would necessarily have been disposed of had the company registered since the statute gave no mandate to a registered company that it must divest itself of the securities. *The loss to shareholders in a declining market would have been just exactly the same*

> *whether the company was registered or whether the company was not registered.* Plaintiff does not allege that the loss in value in United's securities was due to failure to register. We do not see how, in the nature of things, there could be any possible connection between the mere failure to register and the decline in value in United's shares in other companies. The only possible theory on which any such responsibility could be imposed is, we think, the proposition that the statute-violator becomes an insurer against loss of every kind. This, as already pointed out, is not the law."

And so, the Court also stated its conclusion on the matter as follows (R. foll. 152a, p. 10):

> " * * * We think plaintiff, although he has presented his case with great skill, *has failed to show any legal connection between the violation of the Act and the loss.* * * *"

The phraseology of the petition is much too oblique in the presentation of questions claimed to be involved in this case. The basic question presented may be summarized much more directly and succinctly as follows:

May a minority stockholder whose essential grievance relates to a claimed breach of fiduciary duty by corporate officers hoist himself into a federal court by alleging a concomitant, but logically unrelated, violation of a federal statute?

Both the District Court and the Circuit Court of Appeals answered this question in the negative; an answer which, upon the face of this particular complaint seems elementary and obvious, and most certainly involves no broad and significant interpretation of law or statute sufficient to warrant a further review by this Court.

It may be observed, moreover, that the petitioner himself now seems to recognize that the gist of his complaint is

the fancied breach of a common law duty of corporate officers. Faced with the undeniable fact, with respect to the third cause of action in the complaint, that no primary duty is imposed upon corporate officers under Section 11 of the Act, the petitioner now argues (Petition and Brief, pages 40-41) that the statute, by conferring privileges which might have been availed of, "enlarged the fiduciary obligations of the defendants and required that they act for the best interests of security holders, as envisaged by the act rather than in the interests of the affiliated banking interests who dominated and controlled United."

If the petitioner's argument means anything at all, it means merely that the failure to file a voluntary plan under Section 11(e) might be considered a factor in weighing a charge of corporate mismanagement. But the action, if it existed at all, would be a common law action and not one "created" by the statute or one as to which a federal court has jurisdiction under Section 25 of the Holding Company Act.

The Circuit Court's decision is not in conflict with decisions of this Court or of other Circuit Courts

As bearing upon the petitioner's further suggestion (Petition, pp. 12-13) that the decision below is in probable conflict with the decision of this Court in *Texas & Pacific Ry. Co.* v. *Rigsby*, 241 U. S. 33, 36 S. Ct. 482 (1916), and the decision of the Second Circuit Court of Appeals in *Goldstein* v. *Groesbeck, et al.*, 142 F. (2d) 422 (C. C. A. 2nd, 1944), *cert.* denied 323 U. S. 737, 65 S. Ct. 36, it is to be noted that, in the opinion below, Judge Goodrich not only recognized the doctrine of the *Rigsby* case by his reference to Section 286 of the Restatement of the Law of Torts (R. foll. 152a, p. 5), but also recognized the decision in the *Groesbeck* case as authority for the proposition that a private right of action may exist for acts done in violation of Section 4(a)(2) of the Act (R. foll. 152a, p. 7, n. 16).

Indeed, in this latter connection, Judge Goodrich specifically stated (R. foll. 152a, p. 7):

> "We are unwilling to take the position urged by the defendants that the violation of the registration provisions of the statute will never bring about individual liability. Violation has been held liability creating in one situation. It may or may not be in others. This case is decided on a narrower ground. * * *"

CONCLUSION

The decision of the Circuit Court of Appeals on the narrow issue presented to it was clearly correct. It involved no broad interpretation of the Statute in question and it is not in conflict with any other decisions of this Court or of other Circuit Courts. Accordingly, the petition for a writ of certiorari herein should be denied.

Respectfully submitted,

WILLIAM S. POTTER,
Counsel for Respondents
George H. Howard, et al.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 365

EDWARD R. DOWNING, suing on his own behalf and on behalf of all other stockholders of THE UNITED CORPORATION (of Delaware), etc., *Petitioner,*

against

GEORGE H. HOWARD and others

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

STATEMENT FOR DEFENDANTS, ALFRED H. CASPARY, AS ONE OF THE EXECUTORS, AND BANKERS TRUST COMPANY AS TRUSTEE UNDER THE LAST WILL AND TESTAMENT OF THOMAS COCHRAN, DECEASED, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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NEAL M. WELCH,
14 Wall Street,
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Of Counsel.

IN THE

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In order to avoid needless duplication of argument, the undersigned defendants join in the briefs submitted by other defendants in opposition to petitioner's application for a writ of certiorari.

Respectfully submitted,

NEAL M. WELCH,
Counsel for Defendants, Alfred H. Caspary, as one of the executors, and Bankers Trust Company as Trustee under the Last Will and Testament of Thomas Cochran, deceased,
14 Wall Street,
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October 20, 1947.

IN THE

Supreme Court of the United States

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EDWARD R. DOWNING, suing on his own behalf and on behalf of all other stockholders of THE UNITED CORPORATION (of Delaware), etc.,

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BRIEF FOR DEFENDANTS EDWARD HOPKINSON, JR. AND OTHERS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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October 17 1947

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IN THE

Supreme Court of the United States

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Petitioner,

against

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No. 365

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR DEFENDANTS EDWARD HOPKINSON, JR. AND OTHERS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Opinions Below

The opinion of the Third Circuit Court of Appeals (insert following R. 152a) is reported in 162 F. (2d) 654, and the opinion of the District Court (R. 126a) in 68 F. Supp. 6.

Jurisdiction

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. 347). The judgment of the Circuit Court of Appeals was entered June 24 1947. Plaintiff's petition for certiorari was filed September 23 1947.

Statement of the Case

This is a derivative action by a minority stockholder of The United Corporation (a Delaware corporation) against it, numerous officers and directors, and banking firms named as third parties, for waste claimed to have been committed by the defendant directors and officers at the instance of the third parties in the management of the corporation in and after 1935. In the absence of diversity of citizenship (plaintiff and three of the defendants being all citizens of Massachusetts, R. 12a-13a), plaintiff has sought to obtain Federal jurisdiction of the subject-matter and extra-territorial jurisdiction of the individual defendants by injecting into the complaint a charge of violation of the Public Utility Holding Company Act of 1935. Section 25 of this Act (quoted at pp. 4-5 below) confers jurisdiction upon the United States courts "of all suits in equity . . . brought to enforce any liability or duty created by" the Act, and allows process in such suits to be served in any district wherein the defendant is an inhabitant or transacts business or wherever defendant may be found.

The complaint was filed in the United States District Court for Delaware August 10 1944. A year or more later, in reliance upon Section 25, plaintiff caused process to be served upon 23 defendants (or their estates) in Massachusetts, Connecticut, New York and Pennsylvania (R. 1a-7a), three defendants only out of the list of 26 having been served in the forum (Delaware). The amount claimed from the defendants jointly and severally exceeds $100,000,000 (R. 63a).

The amended complaint proceeds under a standard head of equity jurisdiction in accusing the defendant directors and officers as fiduciaries of deliberate mismanagement of

the company for the benefit of the third-party banking firms. But in order to try to bring the claim under the Public Utility Holding Company Act as being one first created by the Act, plaintiff alleges that the defendant directors and officers wrongfully caused the company to remain unregistered under the Act from 1935 to March 28 1938.[1] The theory of the complaint is that from August 26 1935 (the effective date of the Act) the defendant directors and officers "in furtherance of a fraududent conspiracy to waste and dissipate the assets of United" (R. 56a) caused the company to remain unregistered, to retain the stocks of holding companies, and to vote in favor of consolidation of subsidiary holding companies; and that after registration in 1935 they caused it for three years to fail to submit to the Securities and Exchange Commission a proper plan of reorganization and divestment.[2] Thus an attempt is made to spell out a statutory violation, but as a matter of necessity the complaint is replete also with the standard charges of waste, negligence, and fraudulent conspiracy (R. 32a-35a, 37a, 43a, 46a and 56a).

Petitioner concedes that the process of the District Court of Delaware could not run beyond the limits of that district so as to reach the undersigned defendants unless Section 25 of the Act here applies—unless, in other words, the amended complaint upon proper analysis shows the action to be one to enforce a "liability or duty created by" the Act (br. pp. 2, 21).

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[1]Registration on March 28 1938 coincided, as the Circuit Court points out (opinion at p. 4 following R. 152a, 162 F. [2d] at 656), with the decision of this Court upholding the constitutionality of the registration provisions of the statute. *Electric Bond & Share Co.* v. *S. E. C.*, 303 US 419.

[2]The three alleged causes of action are summarized at greater length in the petition, pp. 3-10.

The undersigned nine defendants, together with 16 other defendants represented by other counsel, seasonably moved to dismiss the complaint for lack of jurisdiction (Rule 12[b]). The motions were granted and judgments of dismissal entered (R. 140a, 142a, insert following R. 152a). Judge Leahy in the District Court and a unanimous Circuit Court of Appeals for the Third Circuit reached the conclusion that the action is no more than the standard derivative suit in equity by a minority stockholder to call fiduciaries to account; that it does not seek to enforce a duty or liability first *created* in 1935 by the statute; and that therefore Federal jurisdiction of the subject-matter and of the persons does not exist in the absence of diversity.

Statute Involved

Public Utility Holding Company Act of 1935 § 25 (15 U. S. C. § 79y) provides:

> "Jurisdiction of offenses and suits
>
> The District Courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this chapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law *brought to enforce any liability or duty created by*, or to enjoin any violation of, this chapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or

rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. . . ." (italics supplied)

Question Presented

Petitioner has sought (Pet. pp. 10-11) to state three questions as being presented by his application. Each question is tied in to one of his three alleged causes of action, and he contends that the writ should issue if his position is right as to any one cause of action (p. 11). The question here presented therefore boils down to one only, namely:

Where fiduciaries are charged in a derivative suit with fraudulent conspiracy, waste and negligence, does the added allegation of a breach of the Public Utility Holding Company Act of 1935 transform the derivative suit into one "to enforce any liability or duty created by" that statute, so as to confer jurisdiction upon the United States courts in the absence of diversity of citizenship?

Argument

1. Upon proper analysis the amended complaint here is no more than the standard derivative action in equity.

Petitioner seeks to give the impression that upon this case turns the question whether from now on faithless directors of corporations subject to the Act shall be civilly liable for their dereliction of duty (cf. br. p. 20). As peti-

tioner would have it, the Act "enlarged the fiduciary obligation of directors" (br. pp. 20, 41), by requiring that they act "for the best interests of securityholders" instead of for conflicting interests. Any such contention is so lacking in all foundation as to demonstrate the fallacy of the petition. For a hundred years or more the requirement that company directors act for the best interest of their stockholders, and sanctions against their acting for conflicting interests, have existed in the form of the standard derivative action, as illustrated by the decisions of this Court (*Pepper* v. *Litton,* 308 US 295; *Southern Pacific Co.* v. *Bogert,* 250 US 483), as well as innumerable decisions in the State and lower Federal courts. *Gallin* v. *National City Bank,* 155 Misc. 880; *Loft Inc.* v. *Guth* (Del. Ch. 1938), 2 Atl. (2d) 225, affd. 5 Atl. (2d) 503; *Kavanaugh* v. *Kavanaugh Knitting Co.,* 226 NY 185; *Irving Trust Company* v. *Deutsch,* 73 F. (2d) 121, cert. den. 294 US 708.

If the fiduciary obligation of the defendants sought to be enforced by this action is one which existed before 1935 and the remedy here invoked was likewise previously available, then it is obvious that the present action is not one to enforce a duty or liability first *created* by the Act.[3] Demonstration, if more were needed, is furnished by the pleading of a claim substantially identical with that of this plaintiff, by another minority stockholder in the New York courts, sustained by Mr. Justice Shientag as stating a cause of action at common law, independent of any statute.

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[3] Judge Goodrich well points out this essential weakness of plaintiff in footnote 3, 162 F. (2d) at 655.

Singer v. *Carlisle*, 26 NYS (2d) 172 (1940), affd. on other grounds 261 AD 897.[4]

This pre-1935 common law liability and fiduciary obligation, which indeed the plaintiff here invokes in his pleading (R. 32a-35a, 37a, 43a, 46a, 56a), is of course not materially altered, not changed in quality, by the pleader's adding to the list of wrongs recited a violation of the Public Utility Holding Company Act. Such violation, if it existed, was but an evidentiary detail of the defendants' alleged misconduct. The fiduciary duty and liability of the defendants here sought to be enforced existed before the enact-

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[4]This case was brought against some of the present defendants. The New York Court said, describing the pleading (pp. 179-80):

> "The theory of the third cause of action is the elimination by the fiduciaries of their cestui as a competitor. In other words, plaintiffs charge that the defendant bankers and directors of the United Corporation and New York United Corporation, acting in concert with the defendant bankers, made no effort to obtain the underwriting business in connection with the issue of securities and, further, that the defendant bankers, by virtue of their domination and control over the United Corporation and New York United Corporation, fraudulently caused the latter corporations to use their influence and control over their subsidiaries in order to induce such corporations to award the underwriting business to the defendant bankers. Having thus eliminated the United Corporation and the New York United as their competitors for the underwriting business of the subsidiaries, the defendants, it is alleged, proceeded to utilize their domination, control and influence in order to obtain this business for themselves.
>
> This conduct on the part of the fiduciaries if established on a trial would amount to a violation of their legal obligation to the corporations they were elected to serve and for such violation they would have to respond in damages to the cestuis, namely, the United Corporation and New York United Corporation."

ment of the statute. It is transparent therefore that the statute did not "create" it. But if the statute did not create the duty or liability here sought to be enforced, petitioner agrees that there is no Federal jurisdiction.

2. There is no diversity among the Circuit Courts upon the question presented here.

The only conflict among the Circuits which petitioner claims in respect of the decision below has to do with the decision of the Second Circuit Court of Appeals in *Goldstein* v. *Groesbeck,* 142 F. (2d) 422, cert. den. 323 US 737, although petitioner admits that the opinion of the Third Circuit "did not express any disagreement with the decision in that case" (Pet. p. 13). The claim of a conflict, in other words, is inferential only. It is said that "the bases of the decision are in conflict". However, an analysis of the *Goldstein* case will show that this is not so. The Third Circuit refers to the *Goldstein* case in connection with its statement that violation of the registration provisions of the Act might in certain situations involve liability, which would thus have been "created" by the Act (p. 7 following R. 152a, 162 F. [2d] at 658). However, the further statement of the Third Circuit that the violation alleged in this instance had nothing to do with the duty or liability here invoked rests, we submit, upon unassailable reasoning.

Otherwise with the *Goldstein* case. The wrong there asserted was not a wrong before enactment of the Act and with first made illegal by that event. Judge Clark there said (142 F. [2d] at 425) that the suit

> "is surely to enforce a duty created by the Act, since but for the Act the payment under the service and construction contracts would be innocuous enough. . . ."

Plainly such a holding based upon the specific terms of § 26(b) of the statute declaring void contracts made in violation of the statute, can have no bearing upon the situation here presented of alleged violation of pre-existing equitable duty combined with violation of the Act. The distinction was pointed out by the Second Circuit Court of Appeals itself, in a derivative suit based on the Sherman Act. *Meyer* v. *Kansas City Southern R. Co.*, 84 F. (2d) 411 at 414. This Court denied certiorari, 299 US 607.

3. The canons of construction uniformly applied on questions of Federal jurisdiction forbid judicial extension of that jurisdiction to cases for which Congress has not expressly provided.

If petitioner were right in his claim that Congress by the Public Utility Holding Company Act had "enlarged" the fiduciary obligations of directors and created a new forum to punish their violation, it would have been easy for Congress to say so. When in the course of the enactment Congress desired to provide private civil remedies for enforcing the Act, it so specified, as in Section 17(b) authorizing suits to recover profits from officers and directors of registered holding companies in respect of the purchase and sale of the securities of such companies, or in Section 16, which really "creates" liability for the making of false or misleading statements in applications and other papers filed pursuant to the Act.

But with respect to the civil remedy which petitioner asserts that Congress intended to confer for the purpose of derivative suits against directors in respect of failure of their companies to be registered under the Act, Congress has been conspicuously silent. This fact is most significant under the standard canon of construction of the Federal

jurisdiction which this Court applies. Such construction is restrictive. Jurisdiction will not be inferred where Congress has not expressly conferred it. The rule is so well established that it is sufficient merely to refer to *Indianapolis* v. *Chase National Bank,* 314 US 63, 76-7; *Thomson* v. *Gaskill,* 315 US 442, 446; *Healy* v. *Ratta,* 292 US 263, 270; *Kresberg* v. *International Paper Company,* 149 F. (2d) 911, cert. den. 326 US 764 (1945).

4. The decision below does not determine for other cases the existence of the right of a private party to enforce Sections 4 or 11(e) of the Act where the circumstances render such enforcement appropriate.

Petitioner urges that the question presented here is whether a private party has the right to bring an action for violation of the registration clauses of the Act, arguing at length that the statute was passed for the benefit of investors and that the problem of their protection as a class is presented by this case (br. pp. 22-3 etc.).

It is clear, however, that the Court of Appeals did not pass on this question but on the contrary expressly left it open. The Court said (pp. 7, 9 following R. 152a, 162 F. [2d] at 658, 659):

> "We are unwilling to take the position urged by the defendants that the violation of the registration provisions of the statute will never bring about individual liability. Violation has been held liability creating in one situation. [Reference to *Goldstein* v. *Groesbeck,* 142 F. (2d) 422; cert. den. 323 U. S. 737.] It may or may not be in others. This case is decided on a narrower ground.
>
> . . . . .
>
> Our conclusion is, with regard to plaintiff's first and second claimed causes of action, that we need

not commit ourselves on the question whether violation of registration requirements may in some circumstances be made the foundation of assertion of private rights. We shall answer that question when a case compels us to do so. It is sufficient to say that such circumstances are not here presented by the plaintiff. We think that here, even if the violation of the statute could be made the basis of recovery, this plaintiff has not, even when we take all his allegations as true, brought himself into the area of recovery."

It is thus obvious that the decision here sought to be reviewed passed on a particular state of facts and did not involve any important Federal question or question of general law.

CONCLUSION

The petition presents no conflict among the circuits and no important question of Federal or of general law, but merely an attempt to obtain Federal jurisdiction in a standard minority stockholder's action without diversity of citizenship. The writ should therefore be denied.

Respectfully submitted,

RALPH M. CARSON
Attorney for Defendants Edward Hopkinson, Jr., George Whitney, Thomas W. Lamont, Russell C. Leffingwell, Arthur M. Anderson, Charles D. Dickey, J. P. Morgan & Co. Inc., Eva R. Stotesbury and Charles D. Dickey as Executors under the Last Will and Testament of Edward T. Stotesbury, deceased, and Charles D. Dickey as one of the Executors under the Last Will and Testament of Horatio G. Lloyd, deceased, appearing specially

October 17 1947

IN THE

Supreme Court of the United States

October Term, 1947

No. 365

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Petitioner,

against

GEORGE H. HOWARD, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE DEFENDANTS THORNE AND OTHERS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Opinions Below.

The opinion of the Circuit Court of Appeals (R., following p. 152a) is reported in 162 F. (2d) 654. The opinion of the District Court (R. p. 126a) is reported in 68 F. Supp. 6.

Jurisdiction.

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. 347). The judgment of the Circuit Court of Appeals was entered June 24, 1947. The petition for a writ of certiorari was filed September 23, 1947.

Statement of the Case.

Plaintiff, a minority stockholder of The United Corporation, brought a derivative action against that corporation and numerous officers and directors, by filing a complaint in the United States District Court, District of Delaware, on August 10, 1944, and thereafter, a year or more later, serving the defendants with process in Massachusetts, Connecticut, New York and Pennsylvania (R. 3a-8a), three of the twenty-six defendants only having been served in the State of Delaware.

Jurisdiction of the Federal Court was invoked solely on the alleged ground that this action was authorized by Section 25 of the Public Utility Holding Company Act (15 U. S. C. 79(y)). The defendants on whose behalf this brief is submitted moved to dismiss the complaint under defenses (1) to (5) of Rule 12(b) of the Federal Rules of Civil Procedure. The District Court granted the motions to dismiss, on the ground that the Court lacked jurisdiction over the subject matter of the action (R. 132a-136a). The Court stated in its opinion that in view of its determination as to the lack of jurisdiction, a determination with respect to the other grounds of the motion, such as venue, became unnecessary (R. 136a). The Circuit Court of Appeals for the Third Circuit affirmed this determination, also stating that

it had become unnecessary to pass on the other grounds of the motion (162 F. (2d) at p. 659).

The defendants in this minority stockholder's suit are the directors, former directors of United and certain banking firms which are alleged to have controlled the directors and to have conspired with them. The amount claimed from the defendants jointly and severally is more than $100,000,000. The gist of the complaint is that the defendant directors and officers caused The United Corporation to retain the stocks of subsidiary companies and to vote in favor of the consolidation of subsidiary companies while United continued to remain unregistered under the Public Utility Holding Company Act, and after the registration of the company caused it for three years to fail to submit a proper plan of reorganization and divestment to the Securities and Exchange Commission. It is alleged that defendant directors and officers did this acting "in furtherance of a fraudulent conspiracy to waste and dissipate the assets of United" and for the wrongful purpose of profiting at United's expense and of benefiting the banking firms named as defendants (R. 32a, 43a, 55a, 56a). It is alleged that during the period of non-registration the market value of the securities owned by United depreciated by about $87,000,000 (R. 31a, 36a). It is not claimed that if the company had registered on December 1, 1935 this loss would have been prevented. It is not claimed that if the company had registered it would not have continued to own the securiites in question.

The period during which United failed to register and during which the market value of its securities declined was the period between the effective date of the registration provisions of the Public Utility Holding Company Act, December 1, 1935, and the date of the decision of this Court upholding the constitutionality of those provisions,

March 28, 1938 (*Electric Bond & Share Co.* v. *S. E. C.*, 303 U. S. 419). On that day United registered (R. 29a).*

Both the District Court and the Circuit Court of Appeals have held that the case at bar is not one to enforce a "liability or duty created by" the Public Utility Holding Company Act. The Circuit Court of Appeals emphasized that this was not such an action because the injury of which the petitioner complains did not result from any violation of the Act. It pointed out that the violation of the Act on which plaintiff relies was the holding and voting of the stock in question while the company was unregistered. It went on to hold that since the same loss would have occurred if the company had registered, the injury to United did not result from any violation of the Act, but from other causes, chief among which was the decline in the market value of the securities during that period (162 F. (2d) at p. 658). As the District Court said, this case is just "the traditional minority stockholders' suit for waste and dissipation of assets through breach of common law fiduciary duties" (R. 136a).

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* In this connection we quote from the memorandum filed by the Securities and Exchange Commission as *amicus curiae* in the case at bar in the Court below, to which petitioner makes reference in his petition herein:

> "Immediately after the adoption of the Holding Company Act scores of injunction suits were instituted in courts throughout the country, and the *Bond and Share* proceeding was selected by the Government as an appropriate vehicle for a test case. In official and public statements issued at the time, the Commission, the Attorney General and the Postmaster General disclaimed any intention, unless and until the constitutionality of the Act was sustained by the Supreme Court, to enforce the civil or criminal penalties of the Act or to close the mails to violators, or thereafter to seek penalties for earlier offenses. These statements were incorporated into the stipulation of facts entered into as a basis for the trial in the *Bond and Share* case."

Petitioner concedes in his petition to this Court for a writ of certiorari that the service of process on the undersigned defendants was not effective and the case not properly cognizable by the Federal court unless this is an action to enforce a *liability or duty created* by the Public Utility Holding Company Act, as provided in Section 25 of the Act (Petition, p. 2).

Statutes Involved.

Section 25 of the Public Utility Holding Company Act of 1935 (15 U. S. C., Section 79y) provides:

> "Jurisdiction of offenses and suits
>
> "The District Courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this chapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law *brought to enforce any liability or duty created by,* or to enjoin any violation of, this chapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. * * * "

Other statutes to which reference will be made herein are Sections 4 and 11e of the same Act (15 U. S. C., Section

79d and 15 U. S. C., Section 79k(e)). These statutes are reprinted in full in the appendix to petitioner's brief at pages 43-8.

The Question Presented.

Is this a suit in equity "to enforce any liability or duty created by * * * " the Public Utility Holding Company Act of 1935, within the meaning of Section 25 of that Act, so as to confer jurisdiction of this case upon the United States District Court for the District of Delaware?

Argument.

The complaint fails to set forth any claim to enforce any liability or duty created by the Public Utility Holding Company Act. This case does not involve, nor did the Circuit Court of Appeals decide, any important questions relating to the interpretation of Sections 4a, 4b and 11e of the Act. This case solely involves the application of time-honored principles of the law of causation and of the fiduciary obligations of corporate directors. The decision of the Court below is not in conflict with the decision of the Second Circuit Court of Appeals in *Goldstein* v. *Groesbeck* (142 F. (2d) 422, cert. den. 323 U. S. 737). The Federal Courts have no jurisdiction over this case.

POINT I.

The Circuit Court did not deny the existence of the right of a private party to enforce Sections 4 or 11(e) of the Public Utility Holding Company Act but its decision is confined to a holding that the case at bar is not an action to enforce any liability or duty created by that Act.

The general theory of the complaint is that the defendant directors failed to act with an eye single to the interests of United and engaged in a fraudulent conspiracy to dissipate and waste its assets and to profit certain outside interests in breach of their fiduciary duties (R. 32a-34a, 43a, 55a, 56a). Taking these allegations as true, the defendants would be liable under the time-honored rules governing the conduct of corporate fiduciaries. *Pepper* v. *Litton*, 308 U. S. 295; *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483. Obviously, the Federal courts have no jurisdiction over such a cause of action in the absence of diversity of citizenship.

The only basis of Federal jurisdiction asserted here is that this is an action brought to enforce a liability or duty created by the Public Utility Holding Company Act. Petitioner argues that because that Act makes it unlawful for a holding company to own and vote shares of subsidiaries unless registered, it is such an action. He argues further that the question for this Court to decide is whether an individual stockholder has the right to bring an action for violation of these provisions, and claims that the Circuit Court of Appeals denied the existence of such a right.

We think it is clear that the Circuit Court did not pass on this question, and that it is not involved in the case.

The Circuit Court said (162 F. (2d) at p. 658, 659):

> "We are unwilling to take the position urged by the defendants that the violation of the registration provisions of the statute will never bring about individual liability. Violation has been held liability creating in one situation." (Referring to *Goldstein* v. *Groesbeck*, 142 F. (2d) 422; cert. den. 323 U. S. 737.) "It may or may not be in others. This case is decided on a narrower ground."
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> * * * * * * * * *
>
> "Our conclusion is, with regard to plaintiff's first and second claimed causes of action, that we need not commit ourselves on the question whether violation of registration requirements may in some circumstances be made the foundation of assertion of private rights. We shall answer that question when a case compels us to do so. It is sufficient to say that such circumstances are not here presented by the plaintiff. We think that here, even if the violation of the statute could be made the basis of recovery, this plaintiff has not, even when we take all his allegations as true, brought himself into the area of recovery. We do not see how the Corporation's and therefore shareholders', loss through depreciation of securities or their exchange has been tied into the failure to register. The only possible basis for federal court jurisdiction is under a cause of action 'created' by the Public Utility Holding Company Act of 1935. We think plaintiff, although he has presented his case with great skill, has failed to show any legal connection between the violation of the Act and the loss."

We shall not enter, therefore, into an academic discussion with petitioner as to whether a private party may enforce the registration provisions of the Act under given circumstances.

Petitioner suggests that the application by the Court below of well established principles of causation amounted to a novel interpretation of the Act—namely, an interpretation limiting liability to cases where the violation caused the damage complained of (Pet's. Br., pp. 24-30). That has been the law from time immemorial, and the decisions of this Court so hold. *St. Louis & San Francisco Railroad Company* v. *Conarty*, 238 U. S. 243 (1915); *Lang* v. *New York Central Railroad Company*, 255 U. S. 455 (1921); *Davis* v. *Wolfe*, 263 U. S. 239 (1923).

It will be noted that petitioner has not cited in his brief a single case in which a court, by holding or by dictum, suggests that a violator of a statute is liable for damage irrespective of the cause of such loss.

No doubt *Texas & Pacific Railway* v. *Rigsby*, 241 U. S. 33 (1916) held that where a member of a class for whose benefit a statute was enacted, is damaged, a right of action exists in the damaged party whether or not such right is specifically spelled out in the statute. It is equally clear, however, as this Court has held in discussing the Safety Appliance Act cases, of which the *Rigsby* case is one, that the plaintiff can only recover by establishing that the statutory violation was the proximate cause of the injury. *Davis* v. *Wolfe*, 263 U. S. 239 (1923). There this Court stated the rule as follows (p. 243):

> "The rule clearly deducible from these four cases is that, on the one hand, an employee cannot recover under the Safety Appliance Act if the failure to comply with its requirements is not a proximate cause of the accident which results in his injury, but merely creates an incidental condition or situation in which the accident, otherwise caused, results in such injury; * * *"

Professor Beale has aptly summarized the applicable rule in *The Proximate Consequences of an Act*, 33 Harvard Law Review, pages 633, 637, as follows:

> "Where the act is the failure merely of a legal duty, causation is established only when the doing of the act would have prevented the result; if the result would have happened just as it did whether the alleged actor had done his duty or not the failure to perform the duty was not a factor in the result, or in other words, did not cause it."

In holding that the damage and the profits claimed by the plaintiff in this complaint in the first two causes of action did not result from a violation of this statute, the Circuit Court of Appeals was clearly correct. The illegal act of which the plaintiff complains was the holding and voting of these securities *when the company was not registered*. The lack of registration was the illegal aspect of defendants' act, and not the mere holding and voting of the securities. If the company had registered, it would have been entirely legal and proper for it to hold the securities. There is no allegation in the complaint that if United had registered it would have been required to dispose of the securities or forbidden to vote or exchange them or that the same loss would not have occurred.

Plaintiff argues in his brief that if the defendants had not caused United to continue to own the securities of its subsidiaries, it would not have suffered the loss in the value of those securities. The statute did not make it an offense to hold and vote these securities. The statute merely made it an offense to hold and vote them if the company were unregistered. The qualification of "unless registered" is the essence of the offense. Without it there is no offense. For the plaintiff to bring himself within the Act, therefore, he must show that it was the holding and

voting of the securities, combined with the lack of registration, which caused the damage and resulted in the profit.

We concede that one of the purposes of the Act was to protect the interests of investors in the securities of holding companies, but this protection was to be procured by the requirement of registration, not by the requirement that companies should dispose of all their securities unless registered. This becomes clear when we consider what would have happened if United had been required to sell all the securities in question—of a value of nearly $200,000,000—between the time the Act went into effect on August 26, 1935 and December 1, 1935 when it was required to register. The dumping of these securities within that short period would have had a disastrous effect on their value and market price, and far from being in the interests of investors of United, would have been calamitous. It must be kept in mind that the Act provides that after December 1, 1935, the selling of securities by an unregistered holding company is just as unlawful as the owning or voting of such securities (Section 4(a)(3)). Therefore, plaintiff can complain only of the failure to sell the securities prior to December 1, 1935. There is no affirmative requirement in the Act forcing any public utility holding company to divest itself of its securities prior to that date.

This Court itself has taken pains to point out that even the death sentence provision (Sec. 11(b)) of the Public Utility Holding Company Act "does not contemplate or require the dumping or forced liquidation of securities on the market for cash." *North American Co.* v. *S. E. C.*, 327 U. S. 686, 709. Section 11 of the Act itself which provides for the ultimate dismemberment of certain holding companies, also provides that they shall not be required to divest themselves of the stock of their subsidiaries until after January 1, 1938 and even after that date a grace period of

one year was given under Sec. 11(c). From this it must be apparent that the prohibition against the holding of securities if the company failed to register had the purpose of protecting investors only by tending to enforce registration and not by forcing the immediate sale of the securities. In *Electric Bond & Share Co.* v. *S. E. C.*, 303 U. S. 419 (1938), the Court clearly indicated that Sec. 4(a) was enacted to enforce registration by prohibiting the interstate activities of unregistered companies within the purview of the Act. The Court in that case, at page 442, recognized that these provisions were in the nature of penalties to ensure compliance with the registration provisions of the Act.* The plaintiff can complain, therefore, only if the loss is the result of the failure to register.

What has been said with respect to the proximate cause of the loss in the value of the securities applies equally to the profits allegedly made by the defendants. The complaint is wholly devoid of any allegation to the effect that had the company registered these profits would not have been made. If the company had registered it could have given its underwriting business to any banker of its choice. The most that petitioner can say is that there would have been no "assurance" of these profits because the Securities and Exchange Commission might have disapproved or modified certain transactions. That leaves the question of the connection between the statutory violation and the alleged loss entirely to conjecture and speculation. See: *Tennant* v. *Peoria & P. U. Ry. Co.*, 321 U. S. 29, 32-3 (1944); *A. T. & S. F. Ry. Co.* v. *Toops*, 281 U. S. 351, 354-5 (1930); *New York Central R. R. Co.* v. *Ambrose*, 280 U. S. 486, 489-

* In both the Senate and House Reports (S 621 74th Cong. 1st Session p. 25; H. R. 1318 74th Cong. 1st Session p. 11) the following language occurs: "This section (4(a)) establishes the mechanism by which holding companies are brought under the jurisdiction of the Commission so that the provisions of title I may be effectively administered."

90 (1930); *C. M. & St. P. Ry.* v. *Coogan*, 271 U. S. 472, 478 (1926).

Similarly, the complaint does not allege in the second cause of action that the consolidation complained of and the exchange of the stock pursuant thereto would not have taken place in just the same way if the company had registered. Petitioner's speculations about what the Securities and Exchange Commission might or might not have done if United had been registered will not supply proximate cause.

The third cause of action alleges in substance that the defendants failed to submit to the Securities & Exchange Commission a plan for the reorganization of United and that this was done under the domination and control of the defendant banking groups and in breach of the fiduciary duties of the defendant directors to the detriment of United and for the benefit of said banking groups (R. 55a, 56a). The Public Utility Holding Company Act, however, does not require the submission of any such plan, as was pointed out by the Court below (162 F. (2d) at p. 656). The Act is purely permissive providing that such a plan "may" be submitted (Sec. 11(e), 15 U. S. C. 79k(e)). The complaint charges that the defendants were running United as an "economically unnecessary" holding company (Pet.'s Br., p. 39), in order to make it possible for the banking groups to profit from the banking and investment business of United. If the defendants did not run United with an eye single to the interests of that corporation, they may well have been guilty of a breach of their common law fiduciary obligations. By failing to submit a plan under Section 11(e), however, they did not violate any provisions of the Act, and, therefore, the third cause of action is not one to enforce any liability or duty created by that Act. *Commonwealth & Southern Corp.* v. *S. E. C.*, 134 F. (2d) 747, 751 (C. C. A. 3rd); *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90, 114-5, 119.

POINT II.

There is no conflict between the decision of the Circuit Court in the case at bar and that of the Circuit Court of Appeals for the Second Circuit in *Goldstein* v. *Groesbeck*, 142 F. (2d) 422, cert. den. 323 U. S. 737.

The only conflict among the Circuits which petitioner claims in respect of the decision below has to do with the decision of the Court of Appeals for the Second Circuit in *Goldstein* v. *Groesbeck*, 142 F. (2d) 422, cert. den. 323 U. S. 737, although petitioner admits that the opinion of the Third Circuit "did not express any disagreement with the decision in that case" (Pet. p. 13). The claim of a conflict, in other words, is inferential only. It is said that "the bases of the decision are in conflict". However, an analysis of the *Goldstein* case will show that this is not so. The Third Circuit expressly referred to that case, as shown in the quotation at page 8 above, in support of the statement that violation of the registration provisions of the Act might in certain situations bring about liability. The Third Circuit, however, was correct in going on to hold in the present situation that a stockholder suing corporate directors for causing a corporation to violate Section 4(a) must not only show the existence of the violation, but also that the damage was proximately caused thereby and directly traceable to the breach. These elements were present in the *Goldstein* case.

In the *Goldstein* case, the plaintiff, a stockholder of American Light & Power Co., an intermediate subsidiary of Electric Bond & Share Company, sued to recover back fees which had been paid by American's operating subsidiaries to Bond & Share's service company subsidiaries, pur-

suant to contracts made with Bond & Share, an unregistered holding company. Judge CLARK held that the action was "surely to enforce a duty created by the Act, since but for the Act the payments under the service and construction contracts would be innocuous enough" (142 F. (2d) at p. 425).

Section 26 of the Public Utility Holding Company Act (15 U. S. C. § 79(z)) provides that any contracts made in violation of the provisions of the Act are void. Electric Bond & Share and its subsidiaries were not registered companies at that time and the service contracts made were therefore declared to be void. It followed that the operating subsidiaries which were forced to pay out moneys pursuant to the service contracts had to be placed in "*statu quo*", as Judge CLARK pointed out (142 F. (2d) at p. 426). It was only the violation of the Act in the *Goldstein* case which made illegal the service contracts with the Bond and Share service companies. In that case the payments to the service companies were the direct consequence of the illegal act, and, thus, the illegal act caused the loss. In the case at bar, the lack of registration did not cause the loss, for had the company registered the result would have been the same. On the other hand, if the securities were held for the motives ascribed to the defendants in breach of their fiduciary duties this would have been illegal without reference to the Act.

Conclusion.

From the foregoing it must be apparent that the plaintiff has not alleged any cause of action which meets the jurisdictional requirement of Section 25 of the statute, that it shall be an action to enforce a liability or duty created by the Act. In so far as he may have alleged any cause

of action, it is one to enforce time-honored rules governing the conduct of corporate fiduciaries. In truth, plaintiff, by mentioning a Federal statute, attempts to obtain Federal jurisdiction, although the cause of action is not one to enforce that statute. Such attempts have been uniformly rejected. *Herrmann* v. *Edwards*, 238 U. S. 107 (1915); *Meyer* v. *Kansas City Southern Ry. Co.*, 84 F. (2d) 411 (C. C. A. 2, 1936), cert. denied, 299 U. S. 607 (1936). This is not a case where the courts are called upon to adjudicate the non-federal part of a claim once Federal jurisdiction as to part of the claim is established. This is a case in which no Federal claim is presented. It is not permissible to enlarge the jurisdiction defined in Section 25 of the Act. *Indianapolis* v. *Chase National Bank*, 314 U. S. 63, 76-7; *Thomson* v. *Gaskill*, 315 U. S. 442, 446.

The petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit should be denied.

Respectfully submitted,

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